WILLKIE FARR & GALLAGHER LLP

1875 K Street, N.W.
Washington, DC 20006-1238

Tel: 202 303 1000
Fax: 202 303 2000

REDACTED - FOR PUBLIC INSPECTION

April 29, 2010

VIA COURIER

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Room TW-A325
Washington, DC 20554

Re: ***Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area*, WC Dkt. No. 09-135**

Dear Ms. Dortch:

Please find enclosed for filing in the above-referenced proceeding two copies of the redacted version of the Comments of Integra Telecom, Inc., tw telecom inc., Cbeyond, Inc., and One Communications Corp. Pursuant to the April 15, 2009 Public Notice in this proceeding,[1] electronic copies of the redacted version of the filing will be sent to the Competition Policy Division of the Wireline Competition Bureau and Best Copy and Printing, Inc.

Pursuant to the *Second Protective Order* in the above-referenced proceeding,[2] one original of the highly confidential version of this filing is being filed with the Secretary's Office under separate cover today. Also pursuant to the *Second Protective Order*, two copies of highly confidential version will be provided to Gary Remondino of the Wireline Competition Bureau and electronic copies of the highly confidential version will be sent to Tim Stelzig and Denise Coca of the Wireline Competition Bureau.

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[1] *See Request for Additional Comment and Data Related to Qwest Corporation's Petition for Forbearance From Certain Network Element and Other Obligations in the Phoenix, Arizona MSA*, WC Dkt. No. 09-135, DA 10-647, at 2 (rel. Apr. 15, 2010) ("All other filing requirements set forth in the Public Notice establishing the initial pleading cycle remain in effect.").

[2] *See Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area*, Second Protective Order, WC Dkt. No. 09-135, DA 09-1670 (WCB, rel. July 29, 2009) ("*Second Protective Order*").

Please do not hesitate to contact me if you have any questions or concerns about this submission.

Respectfully submitted,

Thomas Jones
Nirali Patel

Counsel for Integra Telecom, Inc., tw telecom inc., Cbeyond, Inc., and One Communications Corp.

Enclosures

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
	)	
Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area	)))	WC Docket No. 09-135
	)	

COMMENTS OF INTEGRA TELECOM, INC., TW TELECOM INC., CBEYOND, INC., AND ONE COMMUNICATIONS CORP.

WILLKIE FARR & GALLAGHER LLP
1875 K Street, NW
Washington, DC 20006
(202) 303-1000

April 29, 2010

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Federal Communications Commission
Washington, D.C. 20554

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Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area	)))	WC Docket No. 09-135
	)	

COMMENTS OF INTEGRA TELECOM, INC., TW TELECOM INC., CBEYOND, INC., AND ONE COMMUNICATIONS CORP.

Integra Telecom, Inc. ("Integra"), tw telecom inc. ("tw telecom"), Cbeyond, Inc. ("Cbeyond"), and One Communications Corp. ("One Communications") (collectively, the "Joint Commenters"), through their undersigned counsel, hereby submit these comments in response to the April 15, 2010 Public Notice[1] in the above-captioned proceeding.

I. WHEN EVALUATING QWEST'S PETITION FOR FORBEARANCE FROM UNBUNDLING OBLIGATIONS IN THE PHOENIX MSA, THE COMMISSION SHOULD APPLY A STANDARD OF REVIEW BASED ON SOUND PRINCIPLES OF COMPETITION POLICY.

The April 15, 2010 Public Notice seeks comment on "whether, in considering Qwest's Phoenix MSA Petition, [the Commission] should apply a market power-oriented approach along the lines suggested in the FTC-DOJ Horizontal Merger Guidelines."[2] As the Joint Commenters

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[1] *See Request For Additional Comment And Data Related To Qwest Corporation's Petition For Forbearance From Certain Network Element And Other Obligations In The Phoenix, Arizona MSA*, Public Notice, WC Dkt. No. 09-135, DA 10-647 (rel. Apr. 15, 2010) ("April 15, 2010 Public Notice").

[2] *Id.* at 2.

have advocated in their opposition in this proceeding[3] and in their comments on the remands of the *6-MSA Order* and the *4-MSA Order*,[4] when evaluating petitions for forbearance from unbundling requirements, the Commission should: (1) define the relevant product markets based on customer demand patterns;[5] (2) define the relevant geographic market as a Metropolitan Statistical Area ("MSA");[6] and (3) assess the level of competition in each relevant market using

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[3] *See generally* Opposition of Integra Telecom, Inc., tw telecom inc., Cbeyond, Inc., and One Communications Corp., WC Dkt. No. 09-135 (filed Sept. 21, 2009) ("Joint Commenters' Opposition").

[4] *See generally* Comments of Cbeyond, Integra, One Communications and tw telecom, WC Dkt. Nos. 06-172 & 07-97 (filed Sept. 21, 2009) ("Remand Comments") (attached hereto as Attachment A).

[5] *See* Joint Commenters' Opposition at 7-8 (explaining that, at a minimum, the Commission should differentiate the residential market from the business market and the retail market from the wholesale market); *see also* Remand Comments at 16 (explaining that the demand characteristics of retail and wholesale markets are entirely different); *id.* at 10-15 (explaining that the Commission should define the relevant product markets by applying the "hypothetical monopolist" test under the FTC-DOJ Horizontal Merger Guidelines, and where the Commission lacks the necessary pricing information to apply this test, it should review other evidence that bears on whether a price increase would be profitable, such as the prices and characteristics of the services and whether a company's own marketing and advertising materials and strategies reflect its views as to the extent to which customers view products as substitutes). It should be noted that while the recently proposed Revised Merger Guidelines state that "[t]he Agencies' analysis need not start with market definition," they acknowledge that "evaluation of competitive alternatives available to customers is always necessary at some point in the analysis." *See* Revised FTC-DOJ Horizontal Merger Guidelines, at 7 (rel. Apr. 20, 2010), *available at* http://www.ftc.gov/os/2010/04/100420hmg.pdf ("Revised Merger Guidelines"). Moreover, under the Revised Merger Guidelines, the Agencies continue to employ the hypothetical monopolist test to define product markets. *See id.* at 9-12.

[6] *See* Joint Commenters' Opposition at 8-9 (explaining that the Commission should assess competition on an MSA basis because competitors that rely on UNEs must obtain access to those facilities throughout an MSA in order to achieve profitability and serve a community of interest); *see also* "Factual and Legal Support for Competitors' Proposed UNE Forbearance Standard," at 9-11, *attached to* Letter from Thomas Jones, Counsel for One Communications Corp. et al., to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 08-24 & 08-49 (filed Apr. 14, 2009) ("Joint Commenters' April 14, 2009 UNE Forbearance Ex Parte Letter") (attached hereto as Attachment B) (explaining that CLECs that purchase wholesale inputs to provide downstream retail services can generally achieve minimum efficient scale only if they serve geographic areas that are

either the standard proposed by a coalition of competitors in related forbearance proceedings (the "Competitors' Proposed Standard") or a market competition standard based on the FTC-DOJ Horizontal Merger Guidelines (a "Market Competition Standard").[7]

In assessing competition under the Competitors' Proposed Standard, the Commission should determine, for each MSA in which forbearance is sought, whether:

> (1) there are at least two facilities-based non-ILEC wireline competitors in the wholesale loop market, each of which has actually deployed end-user connections to 75 percent of end-user locations, each of which has deployed wholesale operations support systems sufficient to support the wholesale demand in the relevant product market, and each of which has garnered at least 15 percent of wholesale loop market share in the relevant product market ("Wholesale Test");
>
> or
>
> (2) at least 75 percent of end-user locations are served by two or more facilities-based non-ILEC wireline competitors that offer retail service in the relevant downstream product market to the locations in question via loops that the competitors have actually deployed, and there are at least two facilities-based competitors to the ILEC that have each garnered at least 15 percent of retail market share in the relevant product market ("Retail Test").[8]

The Competitors' Proposed Standard could be applied as a presumption test under which an MSA that meets the criteria would be presumed to be eligible for forbearance and an MSA that does not meet the criteria would be presumed to be ineligible for forbearance.[9]

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approximately the size of an MSA). For example, Integra has determined that it must be able to serve the small and medium-sized businesses throughout the Phoenix MSA in order to reach and sustain overall profitability. *See* Joint Commenters' Opposition, Attachment A, Cantrall Declaration ¶¶ 4-5.

[7] *See* Joint Commenters' Opposition at 9-11.

[8] The Commission should establish clear criteria for identifying the firms that should be "counted" as competitors under the Competitors' Proposed Standard. *See* Joint Commenters' April 14, 2009 UNE Forbearance Ex Parte Letter at 16-18.

[9] The requirement under the Competitors' Proposed Standard that at least two facilities-based wireline competitors to the incumbent LEC, each of which has a 15 percent market share in the

Under a Market Competition Standard, forbearance would be granted in the relevant product market in an MSA only where facilities-based competition is sufficient to prevent the incumbent LEC from exercising market power unilaterally or as a result of coordinated conduct.[10] Pursuant to the FTC-DOJ Horizontal Merger Guidelines, potential entry should be considered in the Commission's analysis only if such entry is "timely, likely, and sufficient."[11] Because it is extremely unlikely that the Commission could conclude that a prospective entrant into the markets at issue in UNE forbearance proceedings meets these criteria, the Commission should presume that only actual competition is relevant.[12] In assessing actual competition, the

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relevant product market, must be present before forbearance can be granted is economically sound. *First*, both economic theory and the available empirical evidence indicate that more than one viable competitor to the incumbent is usually required to prevent the harms to consumer welfare, namely supra-competitive prices, resulting from duopoly markets. *See generally* Declaration of Dr. Stanley M. Besen (dated Apr. 22, 2009), *attached to* Letter from Andrew D. Lipman, Counsel for TDS Metrocom, LLC et al. & Thomas Jones, Counsel for Cbeyond, Inc. et al., to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 08-24 & 08-49 (filed Apr. 23, 2009) (attached hereto as Attachment C). *Second*, empirical evidence suggests that while the presence of a third "substantial" firm would reduce the otherwise high price-cost margins of the two leading firms in a duopoly market, "a third firm with only a small market share might have little effect." *See id.* at 8; *see also id.* at 14 (concluding that "without further analysis, one should not be too quick to count fringe or differentiated players as being fully equivalent to major direct competitors").

[10] *See* Remand Comments at 27 (explaining that there must be sufficient facilities-based competition that the incumbent cannot, either through unilateral conduct or tacit collusion, charge prices that significantly exceed a fair measure of cost, degrade service quality, or slow-roll innovation).

[11] *See* FTC-DOJ Horizontal Merger Guidelines §§ 3.0-3.4 & Revised Merger Guidelines at 27-29; *see also* Remand Comments at 20-21. Although the Revised Merger Guidelines have eliminated the presumption that entry will be considered timely only if it can be achieved within two years, the analysis under the Revised Merger Guidelines remains focused on the timeliness, likelihood, and sufficiency of entry. *See* Revised Merger Guidelines at 27-29.

[12] *See* Remand Comments at 21-26 (explaining that, given the characteristics of the telecommunications markets at issue in UNE forbearance proceedings, future entry will almost certainly not be "timely," is not "likely," and will not be "sufficient").

Commission should require that (1) the incumbent LEC faces competition from at least two competitors that utilize their own loop facilities to provide service throughout the MSA, and (2) there are at least two competitors with their own loop facilities that have garnered substantial market share (e.g., 15 percent).[13]

II. REGARDLESS OF THE STANDARD APPLIED, THE MOST RECENT INFORMATION AVAILABLE TO THE JOINT COMMENTERS CONFIRMS THAT QWEST'S PETITION FOR FORBEARANCE FROM UNBUNDLING OBLIGATIONS IN THE PHOENIX MSA SHOULD BE DENIED.

The April 15, 2010 Public Notice seeks comment on "whether the record evidence supports granting forbearance in this proceeding" and invites "interested persons to cite specific evidence in the record or provide new data as needed to support their pleadings."[14] In their April 28, 2010 Ex Parte Filing in this proceeding, the Joint Commenters explained that, regardless of the standard of review applied, the record evidence shows that Qwest's petition for forbearance from unbundling obligations in the Phoenix MSA should be denied.[15] As the Joint Commenters discussed in detail, data submitted in the record by the Arizona Corporation Commission ("ACC") confirms that Qwest faces insufficient facilities-based competition in both the retail business and wholesale markets in the Phoenix MSA to justify forbearance.[16] Moreover, as

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[13] *See id.* at 27-31; *see also supra* note 9.

[14] April 15, 2010 Public Notice at 2.

[15] *See* "Integra Telecom, tw telecom, Cbeyond, and One Communications Presentation Regarding Qwest Phoenix MSA Forbearance Petition, WC Dkt. No. 09-135, April 27, 2010" at 2-7, *attached to* Letter from Thomas Jones, Counsel for Integra Telecom, Inc. et al., to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 09-135 (filed Apr. 28, 2010) ("Joint Commenters' April 28, 2010 Ex Parte Filing").

[16] *See id.* at 2 (explaining that the ACC's data confirms that Qwest, not Cox, dominates the business market in the Phoenix MSA); *id.* at 5-6 (explaining that the ACC's data confirms the lack of intramodal, facilities-based competition in the business market in the Phoenix MSA); *id.*

discussed below, the most recent information available to the Joint Commenters confirms that Qwest's petition should be denied.

First, Integra's most recent cable churn data confirms that most of the competition that Integra faces in the retail business market comes from Qwest, not Cox. Specifically, between August 2009 and March 2010, Integra ported out numbers **[***BEGIN HIGHLY CONFIDENTIAL***]**

[*END HIGHLY CONFIDENTIAL***]** Stated differently, Integra ported out numbers **[***BEGIN HIGHLY CONFIDENTIAL***]** **[***END HIGHLY CONFIDENTIAL***]** to Qwest than to Cox.[17]

Second, the Joint Commenters' most recent on-net building data confirms that there is little intramodal, facilities-based competition in the business market in the Phoenix MSA. In particular, due to the real-world obstacles to self-deployment, Integra had constructed loop facilities to only **[***BEGIN HIGHLY CONFIDENTIAL***]** **[***END HIGHLY CONFIDENTIAL***]** buildings in the Phoenix MSA as of April 27, 2010. Thus, the number of buildings in the Phoenix MSA to which Integra has constructed loops has not changed since August 21, 2009, the vintage of the data previously submitted in the record by Integra.[18]

In addition, as explained in the Joint Commenters' April 28, 2010 Ex Parte Filing, as of the end of the first quarter of 2010, tw telecom had constructed loops to only **[***BEGIN HIGHLY CONFIDENTIAL***]** **[***END HIGHLY**

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at 6-7 (explaining that the ACC's data shows that there are no significant alternative wholesale providers of loops and transport in the Phoenix MSA).

[17] *See also* Joint Commenters' Opposition, Attachment D, Fisher Declaration ¶ 13 (providing Integra's cable churn data for the January 2009 to July 2009 period).

[18] *See* Joint Commenters' Opposition, Attachment B, Bennett Declaration ¶ 6.

CONFIDENTIAL*]** and, as a result, its market penetration has not changed significantly since July 2009, the vintage of the data previously submitted by tw telecom.[19]

Third, in Integra's experience, Cox is still not a viable alternative to Qwest for the wholesale loops needed to serve Integra's business customers in the Phoenix MSA. As previously explained by Integra, due to several factors (e.g., the relatively limited number of buildings served by Cox's fiber loop facilities and the serious limitations of Cox's wholesale OSS capabilities),[20] "Integra ha[d] submitted **[***BEGIN HIGHLY CONFIDENTIAL***]**

[*END HIGHLY CONFIDENTIAL***]** Cox in Phoenix" as of September 21, 2009.[21] This figure remains unchanged.

Fourth, the latest information available to Integra confirms that Qwest faces only limited competition in the provision of wholesale transport facilities in the Phoenix MSA. Specifically, Integra previously submitted in the record tables listing the Phoenix MSA central offices in which Qwest is the only wholesale transport provider and the Phoenix MSA central offices in which Qwest is not the only wholesale transport provider.[22] Integra has found that this information remains unchanged.

Finally, as described in the attached Declaration of Douglas K. Denney, Integra's Director of Costs and Policy, cost studies recently conducted by Integra demonstrate that, if forbearance is granted, Integra would be forced to purchase loops and transport from Qwest as special access (or in the case of 2-wire loops, at the "commercial" rate offered by Qwest),

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[19] *See* Joint Commenters' April 28, 2010 Ex Parte Filing at 5.

[20] *See* Joint Commenters' Opposition, Attachment D, Fisher Declaration ¶¶ 7-8.

[21] *Id.* ¶ 9.

[22] *See id.* ¶ 11 & Exhibits 1-2.

thereby significantly increasing Integra's costs and placing Integra in a price squeeze.[23] Integra has concluded that, as a result, "Integra would not be able to profitably serve customers in the market for DS1-EEL-based services," "Integra would likely be priced squeezed out of the market for 2-wire loop-based services," and it would be "difficult for Integra to justify continuing to offer DS1 loop-based services."[24]

III. CONCLUSION

For the foregoing reasons and those discussed in the Joint Commenters' Opposition and April 28, 2010 Ex Parte Filing, the Commission should deny Qwest's Petition.

Respectfully submitted,

Nirali Patel

Thomas Jones
Nirali Patel
WILLKIE FARR & GALLAGHER LLP
1875 K Street, NW
Washington, DC 20006
(202) 303-1000

Attorneys for Integra Telecom, Inc., tw telecom inc., Cbeyond, Inc., and One Communications Corp.

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[23] *See generally* Declaration of Douglas K. Denney on Behalf of Integra Telecom, Inc. (dated Apr. 28, 2010) (attached hereto as Attachment D).

[24] *See id.* ¶¶ 6, 8-9.

ATTACHMENT A

WILLKIE FARR & GALLAGHER LLP

1875 K Street, NW
Washington, DC 20006

Tel: 202 303 1000
Fax: 202 303 2000

VIA ECFS ***ERRATUM***

September 21, 2009

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Suite TW-A325
Washington, DC 20554

Re: WC Docket No. 06-172, WC Docket No. 07-97

Dear Ms. Dortch:

Earlier today, comments were filed in the above-referenced dockets on behalf of Cbeyond, Inc., Integra Telecom, Inc., One Communications Corp. and tw telecom inc. Those comments lacked a table of contents. The revised version, enclosed below, contains a table of contents. A non-substantive formatting change to the caption is also reflected in the revised version.

Please let us know if you have any questions or concerns in connection with this filing.

Respectfully submitted,

/s/ Jonathan Lechter
Jonathan Lechter

Attachment

BEFORE THE

Federal Communications Commission

WASHINGTON, D.C.

In the Matters of Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas	)))))))	WC Dkt. No. 06-172
Petitions of the Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas	))))	WC Dkt. No. 07-97

COMMENTS OF CBEYOND, INTEGRA,
ONE COMMUNICATIONS AND TW TELECOM

WILLKIE FARR & GALLAGHER LLP
1875 K Street, N.W.
Washington, D.C. 20006
(202) 303-1000

Attorneys for Cbeyond, Inc., Integra Telecom, Inc., One Communications Corp. and tw telecom inc.

September 21, 2009

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BEFORE THE
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Petitions of the Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas	))))	WC Dkt. No. 07-97

COMMENTS OF CBEYOND, INTEGRA, ONE COMMUNICATIONS AND TW TELECOM

Cbeyond, Inc., Integra Telecom, Inc., One Communications Corp. and tw telecom inc. (collectively, "Joint Commenters"), by their attorneys, hereby file these comments in response to the August 20, 2009 Public Notice in the above-referenced dockets.[1]

I. INTRODUCTION AND SUMMARY.

Section 10 of the Communications Act states that the FCC shall forbear from a statutory requirement or a rule where the legal requirement in question is unnecessary to ensure that the rates, terms and conditions of service are just, reasonable and not unjustly or unreasonably discriminatory, where the legal requirement is unnecessary to protect consumers and where forbearance is otherwise in the public interest. Thus, the

[1] *Wireline Competition Bureau Seeks Comment On Remands Of* Verizon 6 MSA Forbearance Order *and* Qwest 4 MSA Order, Public Notice, DA 09-1835, WC Docket Nos. 06-172, 07-97 (rel. Aug. 20, 2009).

touchstone of the forbearance standard is ensuring that customers of telecommunications services are protected from harmful conduct by service providers. In the case of economic regulation, such as unbundling requirements, the legal requirements in question are designed to protect consumers against the abuse of market power by incumbent LECs in the form of prices set far above cost, degraded service quality and foregone innovation.

Accordingly, the FCC should review incumbent LEC petitions for forbearance from unbundling requirements ("UNE forbearance petitions") by applying established principles of economic analysis in order to determine if facilities-based competition is sufficient to yield competitive market outcomes. Unfortunately, the FCC has not done this in the past. Beginning with the order largely granting Qwest's petition for forbearance in Omaha and in all of the subsequent orders addressing UNE forbearance petitions, the FCC analyzed competition without properly defining product markets, without properly assessing the likelihood of future entry, and without assessing impact of a duopoly market structure on consumer welfare. These basic flaws in the applicable standard have yielded flawed decisions. For example, the Commission granted Qwest's petition for forbearance in Omaha based on an unfounded prediction that competition would constrain Qwest's exercise of market power in the wholesale market. Unsurprisingly, that prediction has not come true, causing McLeodUSA, which served end users via Qwest loop facilities, to largely abandon the market.

This remand proceeding offers the Commission an opportunity to avoid such flawed decision making in the future. In its decision overturning the *6-MSA Order*, the D.C. Circuit emphasized that Congress did not mandate any particular mode of analysis for the Commission under Section 10. The FCC is therefore free to adopt an approach that makes sense in light of the overall policy objectives of Section 10. The Commission should use this freedom to abandon its past approach in favor of a standard of review that is firmly rooted in basic principles of competition policy. It should begin by properly defining product markets based on customer demand patterns in accordance with principles set forth in the FTC-DOJ Horizontal Merger Guidelines. Among other things, the FCC must establish separate product market definitions in the wholesale and retail markets and for business and residential services. In addition, the Commission should adopt a sensible geographic area in which to analyze competition. Metropolitan Statistical Areas ("MSAs") are suitable because they reflect the area that UNE-based competitors must generally serve in order to achieve profitability and serve a community of interest in an urban area.

The Commission should then assess the level of competition faced by the incumbent in the relevant product markets within the MSA in which forbearance has been sought. It could do so by utilizing the test that the Joint Commenters and other competitors have proposed ("Proposed Standard"). Under the Proposed Standard, forbearance would only be granted where the incumbent LEC faces competition in the relevant market from at least two competitors that have deployed their own loops to 75 percent of the relevant end user locations and where at least two competitors that offer service via their own loops have each garnered at least 15 percent of the market in the relevant product market. The Commission could use this standard as a bright line test or as a presumption, under which MSAs that meet the criteria in the test are presumed to be eligible for forbearance whereas MSAs that do not meet the criteria are presumed to be ineligible for forbearance.

Alternatively, the Commission could assess the level of competition in the relevant market in an MSA by undertaking a market competition analysis informed by the FTC-DOJ Horizontal Merger Guidelines. Under this approach, forbearance should only be granted in a market where the analysis yields the conclusion that facilities-based competition is sufficient to prevent the incumbent LEC from exercising market power unilaterally or as a result of coordinated conduct. The Guidelines provide a framework for analyzing both potential entry and actual competition. Under the Guidelines, a potential entrant is only considered as part of the competition analysis if such firm's entry is likely, timely (i.e., it will occur within two years) and sufficient (i.e., the competitor's entry will be sufficient in scope and market influence to have a constraining effect on the incumbent's prices). It is extremely unlikely that a prospective entrant into the market at issue in UNE forbearance proceedings would meet the Guideline's criteria for potential entry. The FCC should therefore presume that only actual competition is relevant to the competition analysis.

As to actual competition, the Commission should only account for competitors to the extent that they have deployed their own loop facilities to end user locations in the relevant market and that they have achieved significant market share. The Commission must also determine the number of such non-incumbents, in all events at least two, necessary to constrain the incumbent LEC's exercise of market power. By following these basic principles, the Commission can ensure that forbearance will not be granted prematurely or denied where appropriate.

Finally, the Commission should apply the standard of review adopted in this proceeding to the existing factual record. The FCC is free to decline to re-open the record so long as the submission of new information would not change the outcome of the proceeding. That is the case here because (1) the FCC has the benefit of the substantial information submitted by parties right up to the conclusion of the 6-MSA and

4-MSA proceedings; (2) there is no basis for concluding that facilities-based competition could have progressed materially since the close of those records; (3) the evidence did not indicate that competition was even close to being sufficient to constrain the incumbents' exercise of market power in any product market in any MSA (this is true even for residential telephone service, if properly analyzed); and (4) the incumbents always have the opportunity to seek forbearance in the future in a market in which competition has in fact developed. In any event, if the Commission does re-open the record in this proceeding, it should do so *only* in a specific product market in a specific MSA in which the available evidence indicates that facilities-based competition is sufficient to yield competitive outcomes.

II. BACKGROUND.

In the underlying agency proceedings that led to the *6-MSA Order*[2] and the *4-MSA Order*,[3] interested parties submitted extensive evidence regarding the level of facilities-based competition in the geographic areas at issue. For example, in the 6-MSA proceeding, the Joint Commenters submitted detailed information regarding the extent to which non-incumbent LECs, including the Joint Commenters themselves, and cable operators, have deployed loop and transport facilities in the six MSAs.[4] With few

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[2] *In re Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas*, Memorandum Opinion and Order, 22 FCC Rcd. 21293 (2007) ("*6-MSA Order*"), *remanded, Verizon Tel. Cos. v. FCC*, 570 F.3d 294 (D.C. Cir. 2009) ("*Verizon*").

[3] *In re Petitions of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas*, Memorandum Opinion and Order, 23 FCC Rcd. 11729 (2008) ("*4-MSA Order*"), *remanded, Qwest Corp. v. FCC*, No. 08-1257 (D.C. Cir. Aug. 5, 2009).

[4] *See, e.g.,* Opposition of Time Warner Telecom Inc., Cbeyond Inc., and One Communications Corp., WC Dkt. No. 06-172 at 20-26 (filed Mar. 5, 2007) (describing

exceptions, the incumbent cable operators in the six MSAs submitted extremely detailed information regarding their network deployment.[5] In its petition, reply comments and other filings, Verizon also submitted information regarding the state of competition in the six MSAs.[6] If anything, the record in the 4-MSA proceeding was even more robust.[7] In both proceedings, the FCC examined the record closely and determined in the *6-MSA Order* and the *4-MSA Order* that there was insufficient competition to justify forbearance.

Verizon appealed the *6-MSA Order* and Qwest appealed the *4-MSA Order*. While these appeals were pending, on February 14, 2008 and March 31, 2008, Verizon re-filed petitions for forbearance from unbundling obligations in two of the six markets in which it had sought forbearance in the 6-MSA proceeding (Virginia Beach and Rhode Island),[8]

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network deployment of CLECs); *id.* at 39-46 (describing limitations of cable network facilities); Ex Parte Letter from Brett Heather Freedson, Counsel, XO Communications, LLC, to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 06-172 (filed Nov. 8, 2007) (describing the extent to which XO and other competitors had deployed loop facilities to commercial buildings in the six MSAs).

[5] *See 6-MSA Order* n.71 (listing *ex parte* filings by cable operators).

[6] *See, e.g.,* Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Boston Metropolitan Statistical Area, WC Dkt. No. 06-172 (filed Sept. 6, 2006); Reply Comments of Verizon Telephone Companies, WC Dkt. No. 06-172 (filed Apr. 18, 2007).

[7] *See, e.g.*, Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Colorado Metropolitan Statistical Area, WC Dkt. No. 07-97 (filed Apr. 27, 2007); Erratum to Opposition of Time Warner Telecom Inc., Cbeyond Inc., and Eschelon Telecom Inc., WC Dkt. No. 07-97 (filed Sept. 13, 2007); Letter from J.G. Harrington, Counsel, Cox Communications, Inc. to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 07-97 (filed June 17, 2008) (describing Cox network coverage in Phoenix); *4-MSA Order* n.134 (listing ex parte filings by CLECs describing their network coverage).

[8] These two re-filed petitions covered slightly different geographic areas than the two corresponding petitions in the 6-MSA proceeding. In the 6-MSA proceeding, Verizon had sought forbearance from unbundling requirements in the Providence MSA, which includes all of Rhode Island and parts of Massachusetts, and in the Virginia Beach MSA,

and, on March 24, 2009, Qwest re-filed a petition for the Phoenix MSA, one of the four markets in which it sought forbearance in the 4-MSA proceeding.[9] Apparently because it was concerned that the FCC would likely deny both its Virginia Beach and Rhode Island petitions in a single order, on May 12, 2009, Verizon withdrew both petitions just three days before the statutory deadline for the FCC to rule on the Rhode Island petition.[10] Qwest's Phoenix petition remains pending and was recently docketed by the Commission.[11]

On June 19, 2009, the D.C. Circuit released its opinion in the appeal of the *6-MSA Order*. The court reached two main holdings. First, it rejected Verizon's argument that the FCC must forbear from unbundling obligations where competitors are unimpaired under Section 251(d)(2) and have the theoretical "ability" to compete in the absence of unbundling requirements.[12] Instead, the court held that the FCC need only review petitions for forbearance from unbundling pursuant to the standard set forth in Section 10.[13] That provision only requires that the FCC forbear where (1) enforcement of a

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which includes some areas in which Cox is the incumbent cable company and some areas in which Cox is not the incumbent cable company. In the re-filed petitions, Verizon sought forbearance in Rhode Island only and in only those parts of the Virginia Beach MSA in which Cox is the incumbent cable company.

[9] *See* Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area, WC Dkt. No. 09-135 (filed Mar. 24, 2009).

[10] *See* Ex Parte Letter from Dee May, Vice President, Federal Regulatory, Verizon, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 08-24, 08-49 (filed May 12, 2009).

[11] *See Pleading Cycle Established for Comments on Qwest Corporation's Petition for Forbearance in the Phoenix, Arizona Metropolitan Statistical Area*, Public Notice, DA 09-1653, WC Dkt. No. 09-135 (rel. July 29, 2009).

[12] *Verizon*, 570 F.3d at 300-01.

[13] *See id.*

requirement is not necessary to ensure that rates are just, reasonable and non-discriminatory; (2) enforcement is not necessary to protect consumers; and (3) grant of forbearance is consistent with the public interest.[14]

Second, the court held that, in applying the Section 10 standard, the FCC had failed to explain why it considered only actual competition (i.e., competitors' market share) in the *6-MSA Order* whereas, in prior UNE forbearance orders, it had considered both actual and potential competition. The court therefore remanded the *6- MSA Order* to the FCC. In doing so, it emphasized that "Congress did not prescribe a 'particular mode of market analysis'" in Section 10, that in future proceedings it "may be reasonable" for the FCC to consider an incumbent LEC's possession of a particular market share "as a key factor in the agency's determination that a marketplace is not sufficiently competitive" and that it "may also be reasonable for the FCC to consider only evidence of actual competition rather than actual and potential competition."[15] This same guidance now applies to the remand of the *4-MSA Order*, which the D.C. Circuit issued in response to the FCC's request for a voluntary remand of that order after the court's release of the *Verizon* decision.

III. THE FCC SHOULD ADOPT A STANDARD UNDER WHICH FORBEARANCE IS DENIED UNLESS FACILITIES-BASED COMPETITION IS SUFFICIENT TO PREVENT THE EXERCISE OF MARKET POWER.

As the Joint Commenters have explained numerous times in these and other proceedings, the standards applied by the Commission for reviewing UNE forbearance petitions in the past have been fatally flawed. Most obviously, the FCC has failed to

[14] 47 U.S.C. § 160(a).

[15] *Verizon*, 570 F.3d at 304.

define product markets correctly, relied on future entry without seriously assessing the reliability of such predictions, and failed to account for the harms caused by duopolistic markets. These flaws inevitably led to bad policy outcomes. Most obviously, in the *Omaha Order*, the Commission granted Qwest forbearance from unbundling requirements based on its prediction that retail competition would constrain Qwest's exercise of market power in the wholesale market in Omaha, something that appears not to have occurred. As a result, McLeodUSA has largely abandoned the Omaha market, and consumers have suffered the consequences of diminished competition.[16] Moreover, if the FCC were to continue to apply a standard similar to the one it has applied in the past, it would likely make other, similar errors.

Thus, in considering the remand of the *6-MSA Order* and the *4-MSA Order*, the FCC must abandon its past approach to UNE forbearance petitions and adopt a new standard of review that is rooted in sound principles of market analysis. The Commission's analysis must begin by defining relevant product markets based on customer demand patterns and by utilizing an appropriate geographic area. The Commission should then assess the level of competition within the relevant market by applying the standard of review proposed by the Joint Commenters and other competitors or by undertaking a market power analysis. Either way, it is critical that the FCC deny forbearance unless the incumbent LEC faces a sufficient level of actual competition in a relevant market to discipline the rates, terms and conditions under which the incumbent LEC offers service.

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[16] *See* Letter from Brett P. Ferenchak, Counsel, McLeodUSA d/b/a Paetec, to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 02-33 (filed June 11, 2009) (enclosing notice of discontinuance for Omaha MSA).

A. The FCC Should Define Product Markets Based On A Careful Analysis Of Customer Demand Patterns.

The FCC should follow the methodology set forth in the FTC-DOJ Horizontal Merger Guidelines[17] for defining product markets. Under that methodology, product markets are defined based on customer demand.[18] Specifically, a product market is a product or group of products "such that a hypothetical profit-maximizing firm that was the only present and future seller of those products ('monopolist') likely would impose at least a 'small but significant[19] and nontransitory' increase in price" ("SSNIP").[20] For example, if a monopolist of product A significantly increases the price for A, some customers might pay the higher price, some might switch to an alternative and some might cease purchasing the category of service altogether. If enough customers continue to pay the higher price such that the resulting profits outweigh losses caused by customers who switch to alternatives or who cease purchasing the category of product

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[17] *See* U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines (Apr. 2, 1992, rev. Apr. 8, 1997) ("FTC-DOJ Horizontal Merger Guidelines" or "Guidelines").

[18] *Id.* § 1.0 ("Market definition focuses solely on demand substitution factors -- i.e., possible consumer responses."). In particular, the inquiry concerns the extent to which customer demand is elastic or inelastic. If buyers are more likely to switch products or eliminate purchases all together in response to a price increase, they are considered to have "elastic" demand; if they are less likely to switch or eliminate purchases all together in response to a price increase, they have "inelastic demand." *See* PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 507(a) (3d ed. 2007) ("*Areeda*") ("[T]he price elasticity of demand measures the percentage change of the quantity demanded of some good in response to a given price change."). Demand substitutability and elasticity are also key to measuring market power. *See id.* ¶ 506(a) ("[T]he degree of market power depends on the response of buyers to price changes. Greater responsiveness (greater elasticity of demand) minimizes market power.").

[19] The Guidelines suggest that a five percent increase in price would be considered "significant" in most cases. Guidelines § 1.11.

[20] *See id*. § 1.11.

entirely, then product A constitutes a separate product market. On the other hand, if a price increase in product A would yield a net loss to the hypothetical monopolist,[21] then the regulator must expand the products in the product market by including the closest substitutes to A.[22] Once the group of products at issue would enable a hypothetical monopolist to profit from a significant and nontransitory price increase, the parameters of the product market are established.

Importantly, alternative products that some customers, even a significant percentage of customers, buy in response to a price increase are excluded from the

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[21] The inflection point between profit and loss is reached at the "critical sales loss." *See Areeda* ¶ 536; *id.* n.1 ("The critical sales loss is defined as the decrease in sales resulting from a hypothetical price increase that is just large enough to make the price increase unprofitable.") (internal cites omitted)); *see also* PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW: AN ANALYSIS OF ANTITRUST PRINCIPLES AND THEIR APPLICATION ¶ 562(d) (Supp. 2009) (citing *FTC v. Whole Foods Market, Inc*., 502 F.Supp. 2d 1 (D.D.C. 2007)) ("There is a profit detriment to the price increase equal to the product of the per unit gross margin and the number of units lost. But there is also an economic gain from the increased gross margin earned from the higher price on each remaining unit sold. The 'critical loss' is the amount of lost sales at which the economic detriment equals the economic gain. It is a 'critical' loss because any greater loss will result in the economic detriment exceeding the economic gain, thereby rendering the price increase unprofitable.").

[22] *See* Guidelines § 1.11 ("Specifically, the Agency will begin with each product (narrowly defined) produced or sold by each merging firm and ask what would happen if a hypothetical monopolist of that product imposed at least a 'small but significant and nontransitory' increase in price, but the terms of sale of all other products remained constant. If, in response to the price increase, the reduction in sales of the product would be large enough that a hypothetical monopolist would not find it profitable to impose such an increase in price, then the Agency will add to the product group the product that is the next-best substitute for the merging firm's product."); *see also Areeda* ¶ 506(c) ("Whether a defendant accounting for the entire production of one product has market power notwithstanding the availability of…substitutes depends on several factors: (i) Within the range of output choices realistically available to the defendant, how many buyers consider other products to be interchangeable? (ii) At what relative prices do those buyers consider the products interchangeable? (iii) What are the relative costs of the defendant and those producing the substitute commodities? (iv) Can the defendant discriminate in price among buyers by charging a lower price only to those for whom other products are highly interchangeable?").

product market if such substitution is insufficient to prevent the price increase from yielding a profit. There are therefore many circumstances in which a product market (consisting of product A) excludes a product (call it product Z) even though a large (but insufficient) percentage of purchasers of A view Z as a substitute for A. For example, the FTC found that so-called "superpremium" ice cream constitutes a separate product market because enough ice cream purchasers would continue to purchase superpremium ice cream even if the price were increased such that a price increase would be profitable.[23] There is little doubt that many ice cream purchasers view premium and non-premium ice cream as a substitute for superpremium ice cream, but there are not enough such customers to include premium or non-premium ice cream in the market for superpremium ice cream.

Furthermore, as Dr. Kent Mikkelsen has explained in a paper filed in the 4-MSA docket, customers who have in the past abandoned product A in favor of product Z are irrelevant to the inquiry of whether product Z belongs in the same product market as product A.[24] The relevant inquiry for product market definition purposes is whether a

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[23] *See DOJ-FTC Commentary on the Horizontal Merger Guidelines* (Mar. 2006), *available at* http://www.usdoj.gov/atr/public/guidelines/215247.pdf ("*Commentary*") at 6 (discussing *Nestle-Dryer's* (FTC-2003)) ("Ice cream is differentiated on the basis of the quality of ingredients. Compared to premium and non-premium ice cream, superpremium ice cream contains more butterfat, less air, and more costly ingredients. Superpremium ice cream sells at a substantially higher price than premium ice cream. Using scanner data, Commission staff estimated demand elasticities for the superpremium, premium, and economy ice cream segments. Staff's analysis showed that a hypothetical monopolist of superpremium ice cream would increase prices significantly. This, together with other documentary and testimonial evidence, indicated that the relevant market in which to analyze the transaction was superpremium ice cream.").

[24] *See generally* White Paper of Kent. W. Mikkelson, *Mobile Wireless Service to "Cut the Cord" Households in FCC Analysis of Wireline Competition* at 3, attached to Letter of Brad Mutschelknaus *et al*., Counsel, Covad *et al*., to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 07-97 (filed Apr. 22, 2008).

hypothetical monopolist could profitably increase the price paid by *existing* purchasers of product A.[25] Customers that no longer purchase A are not part of the inquiry.

In fact, after the loss of market share to producers of Z, it might be easier for a producer of A to impose a price increase because a substantial portion of the market that would view the products as substitutes has already switched to product Z. Following the shift to Z, the remaining buyers of product A are likely to have less elastic demand and are therefore less likely to switch because of a price increase in product A. Therefore, the producer of A will be able to set a new, higher profit-maximizing price for those remaining customers. As Dr. Stanley Besen has explained elsewhere,

> [A] firm that loses customers because new substitutes become available may have even greater market power over its remaining customers than it did initially, although its profits would, nonetheless, decline. This can occur if the customers that the firm retains are less sensitive to price increases than those that had switched to the substitutes. In such cases, the *increase* in competition can actually lead to an *increase* in price.[26]

For example, empirical studies examining market prices of brand name drugs following entry by producers of lower priced generic drugs show that the market power of makers of brand name drugs actually increases following generic entry.[27] This is the case even where generic drugs attract a substantial market share (40-50 percent) of the market and the price of generic substitutes continues to decline as additional generic

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[25] *See id.* at 8-9.

[26] *See* Declaration of Stanley M. Besen ¶ 9 ("*Besen Market Power Declaration*"), attached to ex parte letter of Thomas Jones, Counsel, tw telecom inc., to Marlene H. Dortch, Secretary, FCC, WC Dkt. No. 05-25 (filed July 9, 2009) ("*Special Access Letter*").

[27] *See Besen Market Power Declaration* n.15 ("A widely cited claim is that pharmaceutical companies may be able to raise prices to customers who insist on branded products after suppliers of generics have attracted many of their other customers. This can occur if customers who strongly prefer the branded product are less sensitive to price increases that the customers who switched to generics.").

entry occurs.[28] A substantial portion of drug purchasers are simply unwilling to switch to lower price generics, increasing the brand name producer's market power over the non-switchers and permitting an increase in price over the portion of the market that highly values brand name drugs.[29] The authors of one study found that their results were "consistent with notions of market segmentation on the demand side with buyers with differing sensitivities to price."[30]

These principles and studies have important implications for product market definitions in the UNE forbearance context. The touchstone of the Section 10 standard is that forbearance shall only be granted where the legal requirement in question is no longer necessary to ensure that rates are just, reasonable and not unjustly or unreasonably discriminatory. The product market definition methodology discussed herein hews closely to this principle by identifying the category of customers who would be harmed by a significant price increase. It does not matter to such customers that other customers may view alternatives as substitutes. Rather, if there are a sufficiently high number of customers who will continue to purchase A (e.g., wireline telephone service) even after a substantial price increase such that the price increase will be profitable, then A must be

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[28] *See* Richard G. Frank and David S. Salkever, *Generic Entry and the Pricing of Pharmaceuticals*, 6 J. of Econ. & Mgmt. Strategy 75, 89 (No. 1, Spring 1997) ("Frank & Salkever"); *see id*. ("[I]t appears that more competition among generic drug producers is linked to price reductions for those [generic] drugs….[i]ncreased competition from generics is not accompanied by lower prices for brand name drugs….In fact, the evidence we did uncover is consistent with small price rises being tied to expanded competition.").

[29] *See* D.R. Work & M.E. Domino, *The Cost of Prescription Drugs: Rising Concerns over Equity, Fairness and Access to Essential Care*, 64 N.C. Med. J. 270, 271 (Nov./Dec. 2003) ("As Frank and Salkever (1997) have pointed out, producers of brand name products have the ability to retain the least sensitive component of demand and can raise prices to this segment in order to maximize their profits.").

[30] Frank & Salkever at 90.

viewed as a separate product market from Z (e.g., wireless telephone service). Indeed, as explained, it may well be that these customers are even more susceptible to price increases if a substantial portion of a legacy customer base has already abandoned the service in question for an alternative (this is likely the case where a significant number of customers has abandoned wireline telephone service in favor of wireless service).

While this discussion has focused on the SSNIP test, there are likely to be many circumstances in which the FCC lacks the necessary pricing information to apply this test as a technical matter. In these circumstances, the Commission should review other evidence that bears on whether a price increase would be profitable, such as the prices and characteristics of the services and whether a company's own marketing and advertising materials and strategies reflect its views as to the extent to which customers view products as substitutes.[31] If an incumbent LEC consistently increases the price for wireline telephone service, for example, it clearly believes that enough existing wireline customers will continue to purchase the service after the price increase to make increasing the price profitable.

[31] For example, the Joint Commenters have utilized this kind of information to demonstrate that residential telephone services belong in a different product market from business telephone services. *See* Letter from Thomas Jones *et al.*, Counsel, One Communications Corp. *et al*., to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 08-24 & 08-49, at 13-16 (filed Apr. 14, 2009) ("Joint Commenters' April 14th UNE Forbearance Ex Parte Letter") (explaining that: (1) the service features and characteristics demanded by and marketed to even the smallest business customers are qualitatively differnt from those demanded by and marketed to residential customers; (2) the differences in the levels of customer support and features demanded by residential and small business customers are reflected in the different prices charged for those services; (3) competitors' practices for marketing and advertising to small business customers are different than would be the case if they sought to acquire residential customers; (4) competitors such as Integra and One Communications provide more proactive and personalized customer service to their business customers than they would if they served residential customers; and (5) competitors that serve only business customers must design their networks differently than would be the case if they served residential customers).

Finally, it is important to emphasize that, in defining product markets for purposes of UNE forbearance proceedings, the FCC must assess relevant wholesale and retail markets separately. This is because the demand characteristics of these sectors are completely different. Wholesale customers seek access to network elements that they can combine with their own networks in order to provide finished services to end user customers. The "products" at issue are therefore stand-alone loop and transport facilities and the wholesale operations support systems that are necessary to make them available. In contrast, retail customers demand finished retail services for which network elements are merely inputs. Given that wholesale network elements and retail services could not possibly be viewed as substitutes, the two types of service must be analyzed separately.

B. The FCC Should Utilize MSAs As The Relevant Geographic Area For Purposes of UNE Forbearance.

As the Commission has often recognized, the relevant geographic market for wireline telecommunications services such as the loops that are subject to UNE forbearance is a point-to-point connection. But it is not feasible for the FCC to conduct a competition analysis of each separate point-to-point circuit in the market.[32] Accordingly, the FCC must utilize a larger geographic area that sensibly aggregates multiple point-to-point circuits.[33] As the Joint Commenters have explained in connection with the competitors' jointly proposed standard of review for UNE forbearance petitions, MSAs

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[32] *See, e.g., In re Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area et al.*, Second Report and Order in CC Docket No. 06-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd. 15756, ¶ 5 (1997) ("We define the relevant geographic market for interstate, domestic, long distance services as all possible routes that allow for a connection from one particular location to another particular location (*i.e.*, a point-to-point market).").

[33] Indeed, the Commission has recognized that "assessing market power in each individual point-to-point market would be administratively impractical and inefficient." *See id.* ¶ 66.

are the most appropriate means of aggregating geographic markets. This is because, in order to establish minimum efficient scale, a competitor must obtain access to loop facilities on an MSA-wide basis.[34] Thus, the competitive effects of eliminating UNEs would likely be experienced throughout an MSA. It makes sense therefore to assess the extent to which UNEs are available on an MSA-wide basis.

C. The FCC Should Assess The Level Of Competition By Either Applying The Competitors' Proposed Standard Or By Conducting A Competition Analysis.

In assessing the level of competition within the relevant product market in an MSA, the Commission should take one of two approaches. It should adopt the competitors' proposed standard of review or undertake a competition analysis informed by the FTC-DOJ Horizontal Merger Guidelines in the relevant market. In both cases, the objective should be to ensure that forbearance is only granted in markets in which the incumbent is unable to exercise market power, either unilaterally or as a result of coordinated conduct, to charge prices significantly above cost.

1. The Competitors' Proposed Standard.

On March 26, 2009, the Joint Commenters, as part of a coalition of competitors, proposed a new standard for FCC consideration of incumbent LEC petitions for forbearance from unbundling obligations.[35] Under the Proposed Standard, a UNE

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[34] *See* Joint Commenters' April 14th UNE Forbearance Ex Parte Letter at 9-11 (explaining that CLECs that purchase wholesale inputs to provide downstream retail services can generally achieve minimum efficient scale only if they serve geographic areas that are approximately the size of an MSA and that, accordingly, the competitive effects of eliminating UNEs should be assessed on an MSA basis).

[35] *See* Letter from A. Lipman *et al.*, Counsel, Alpheus Communications, L.P. *et al.*, to Marlene H. Dortch, Secretary, FCC, *In re Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island*, WC Dkt. No. 08-24; *Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. §*

forbearance petition should be granted in an MSA only where the following conditions exist:

> (1) at least two facilities-based non-ILEC wireline competitors in the wholesale loop market, each of which has actually deployed end-user connections to 75 percent of end-user locations in the relevant product market, each of which has deployed wholesale operations support systems sufficient to support the wholesale demand in the relevant product market, and each of which has garnered at least 15 percent of wholesale loop market share in the relevant product market ("Wholesale Test");
>
> or
>
> (2) at least 75 percent of end-user locations are served by two or more facilities-based non-ILEC wireline competitors that offer retail service in the relevant downstream product market via loops that the competitors have actually deployed, and there are at least two facilities-based competitors to the ILEC that have each garnered at least 15 percent of retail market share in the relevant product market ("Retail Test").

The Proposed Standard establishes a sound, administrable and predictable framework for consideration of UNE forbearance petitions. It establishes clear criteria for identifying the firms that should be "counted" as competitors under the Wholesale and Retail Tests.[36] The Proposed Standard also utilizes clear benchmarks and allows forbearance to be granted only where the incumbent LEC faces actual competition from multiple (i.e., at

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160(c) in Cox's Service Territory in the Virginia Beach Metropolitan Statistical Area, WC Dkt. No. 08-49 (filed Mar. 26, 2009) (setting forth the Proposed Standard).

[36] *See* Joint Commenters' April 14th UNE Forbearance Ex Parte Letter at 16-18 (explaining why (1) under the Proposed Standard, a facilities-based non-ILEC competitor must be a *wireline* provider in order to qualify as a competitor; (2) under the Proposed Standard, each competitor must have captured at least 15 percent of the market share in the relevant product market; (3) under the Wholesale Test of the Proposed Standard, each facilities-based non-ILEC wireline competitor must have *actually deployed* end-user connections to 75 percent of the relevant end-user locations in an MSA; (4) under the Wholesale Test, each facilities-based non-ILEC wireline competitor must have developed sufficient wholesale operations support systems to accommodate the wholesale demand in the relevant product market; and (5) under the Retail Test of the Proposed Standard, at least 75 percent of end-user locations must be served by two or more facilities-based non-ILEC wireline competitors using loops that the competitors have actually deployed).

least two) competitors, each of which has captured at least 15 percent of the market share in the relevant product market, throughout the MSA.[37]

The Commission could either use the Proposed Standard as a bright line test for assessing UNE forbearance petitions or as a presumption under which an MSA that meets the criteria in the Proposed Standard would be presumed to be eligible for forbearance whereas an MSA that does not meet the criteria would be presumed to be ineligible for forbearance. Either way, application of the Proposed Standard would be relatively easy for the Commission to administer and would give both incumbent LEC petitioners and their competitors the benefit of greater transparency and predictability. Such an approach would also further the goals underlying the FCC's recently adopted forbearance procedural rules.[38] As the Commission recently held, forbearance proceedings should be more transparent,[39] "more manageable for the Commission" and "more predictable" for the parties involved.[40] The competitors' Proposed Standard would achieve these objectives.

[37] *See id.* at 18-25 (explaining that a post-forbearance duopoly structure would likely result in supra-competitive prices and other competitive harms and that, at a minimum, three facilities-based competitors are necessary to prevent such harms); *see also* Letter from Thomas Jones, Counsel, One Communications Corp. *et al.*, to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 08-24 & 08-49, at 2-10 (filed Apr. 23, 2009) ("Joint Commenters' April 23rd UNE Forbearance Ex Parte Letter") (explaining why the Proposed Standard's requirement that at least two facilities-based wireline competitors to the incumbent LEC, each of which has a 15 percent market share in the relevant product market, must be present before forbearance can be granted is sound from both a legal and an economics perspective).

[38] *See generally In re Petition to Establish Procedural Requirements to Govern Proceedings for Forbearance Under Section 10 of the Communications Act of 1934, as Amended*, Report and Order, 24 FCC Rcd. 9543 (2009).

[39] *Id.* ¶¶ 10, 24.

[40] *Id.* ¶ 12.

2. Competition Analysis.

While the Proposed Standard would fully meet the mandates of Section 10, there are other appropriate ways in which the FCC can examine whether competition is sufficient in a market to warrant forbearance. The most obvious alternative approach would be a market competition analysis modeled, to the extent possible, on the manner in which the level of competition in a market is analyzed under the FTC-DOJ Horizontal Merger Guidelines. The relevant components of that analysis are discussed below.

Potential Entry. The Guidelines differentiate between so-called "committed entry," which is entry that requires "expenditure of significant sunk costs of entry and exit" and so-called "uncommitted entry," which is entry that does not require significant sunk costs. As the FCC has held, the deployment of loop and transport facilities requires substantial investment in sunk costs.[41] Accordingly, the principles applicable to committed entry should be applied when considering potential entry in a UNE forbearance proceeding.

In analyzing potential committed entry, the Guidelines focus on three separate factors: whether entry would be (1) timely, (2) likely, and (3) sufficient in magnitude, character and scope to counteract the competitive effects of concern (in this case, the

[41] *See In re Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd. 2533, ¶ 72 (2004) ("*TRRO*") ("The deployment of transport facilities involves substantial fixed and sunk costs. Once a carrier deploys fiber on a route, that fiber cannot be moved to another location."); *id*. ¶ 150 ("The economics of deploying loops are determined by the costs associated with such deployment and the potential revenues that can be recouped from a particular customer location. Competitive LECs face large fixed and sunk costs in deploying competitive fiber, as well as substantial operational barriers in constructing their own facilities.").

elimination of competition as the result of forbearance).[42] Only when all three factors are met will the DOJ and FTC consider the entrant's effect on the market.

Entry is generally considered "timely" if it occurs within two years "from initial planning to significant market impact."[43] Time to entry includes the time to complete all preliminary steps, including product development and the time necessary to develop a reputation such that customers will consider the product.[44]

Entry is "likely" if it "would be profitable at pre merger prices [in this case at pre-forbearance prices] and if such prices could be secured by the entrant."[45] Profitability is dependant upon the entrant's ability to achieve minimum viable scale ("MVS"). MVS is the "smallest average annual level of sales that the committed entrant must persistently achieve for profitability at pre-merger prices."[46] MVS will be large when the fixed costs of entry are significant and largely sunk, as is the case for facilities-based entry into telecommunications markets.[47]

Several factors are present in markets in which incumbent LECs seek forbearance that make it extremely unlikely that a future entrant could achieve MVS. For example, it

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[42] *See* Guidelines § 3.0.

[43] *See id.* § 3.2.

[44] *Id*.; *Commentary* at 46.

[45] Guidelines § 3.3. In determining whether entry is appropriate, a firm must also take into account that its entry will increase supply in the market, which, all things being equal, will drive down prices below the level prior to their entry. *See Areeda* ¶ 421(a).

[46] Guidelines § 3.3.

[47] *Id*. n.31. Costs are considered sunk if "they cannot be recovered by reversing the entry decision." *Commentary* at 37. Sunk costs include not only the costs of tangible assets that cannot be recovered if entry is not achieved, but also intangible assets, such as training employees, learning about the market and designing products. *See Areeda* ¶ 421(c).

is less likely that future entrants will achieve MVS in markets where (1) entrants are unable address a portion of the market due to vertical foreclosure by incumbents and incumbents' long-term contracts that lock in demand (such as special access volume and term discount agreements in business markets);[48] (2) there is evidence that companies have attempted to enter the market and failed in the past (as is the case with many CLECs that have attempted to enter both the residential and business markets);[49] (3) customers demand an established track record of performance and customers are severely harmed if the service does not function at a high level of reliability (which is the case with telecommunications services, especially those provided to business customers);[50] and (4) incumbents possess cost advantages due to superior economies of scale (this is true of most telecommunications markets because incumbents possess substantial economies of scale and scope);[51] or because entry requires the purchase of extremely expensive

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[48] *See* Guidelines § 3.3; *Commentary* at 45 (discussing *Waste Management-Allied* (DOJ 2003)). There, the DOJ ordered a waste transport company to divest certain routes and assets because entrants would be unable to achieve MVS in their absence. A potential entrant would have had to contract with a large number of customers in a small commercial area to reach viability. The DOJ found that this was impossible because the incumbents had locked up nearly all of the demand through long-term contracts. *See id.; see also Areeda* ¶ 421(f) ("An entrant needs access to a sufficient number of customers to allow profitable operation at an efficient scale…Incumbents, however, might obstruct such access in several ways…Tying, exclusive dealing, or long-term supply contracts also narrow the universe of customers available to entrants…Whether such obstructions effectively deter entry depends on the their extent, the customer base needed for efficient production, the likelihood that new customers will themselves enter, the distribution method and the duration of the restraint.").

[49] *See Commentary* at 39.

[50] *See id.* at 40 ("A merger is especially unlikely to attract entry if product failure imposes a substantial cost on customers.").

[51] *See id.* at 38 (noting that entry may not occur if "entrants would suffer significant cost disadvantages in competing with incumbents. This situation can occur for a variety of reasons, but tends to be most important when entrants would be unlikely to achieve the economies of scale (i.e., reductions in average cost from operating at a higher rate of

facilities, the cost of which has already been amortized by the incumbent (such as the deployment of copper or fiber facilities).[52]

Entry will not be "sufficient" in magnitude, character and scope if the "tangible and intangible assets required for entry [i.e., inputs]" are not available to entrants due to the incumbent's control of these inputs or where entrants are restricted from addressing a substantial portion of the market due to the incumbent's long-term contracts.[53] For example, where an entrant seeks to deploy loop facilities to end users, it is unlikely to be able to do so profitably at the locations with limited demand for telecommunications services within an MSA. Where this is the case, the competitor would be unable to serve a substantial portion of the market. Such a competitor is unlikely to constrain the incumbent LEC's prices throughout the MSA. Rather, such entry is better understood as fringe competition.[54]

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output) and scope (i.e., reductions in cost from producing several products together) already achieved by incumbents.").

[52] *See id.* at 45 (discussing *Federal-Mogul-T&N* (FTC-1998)). There, the FTC found that "[a] new entrant that attempted to match an incumbent's product line [in ball bearings] would have been able to amortize the tooling for many bearings over the portion of the [life of the machine used to make bearings], and would necessarily have higher relative costs. This would have put any entrant in the aftermarket at a substantial cost disadvantage to the incumbent firms. Thus the Commission found that entry would not be timely or likely to prevent anticompetitive effects." *See id.*

[53] Guidelines § 3.4; *see Commentary* at 44 ("A merger may lead to price increases without attracting entry because potential entrants would be unable to obtain a source of supply for essential inputs….Difficulty in securing essential inputs can impede entry in a variety of contexts, particularly when incumbents own or control access to the inputs."); *Areeda* ¶ 422(c) (noting that entry will not be sufficient if the entrant cannot obtain "access to needed inputs or customers").

[54] *See* Guidelines § 3.4; *Areeda* ¶ 422(c) ("Especially in product-differentiated markets, new entrants may find small market niches that have little impact on market prices generally….Entry into a small corner of the market may be easy, while entry into the remainder [sufficient to affect prices] is very difficult.").

As this discussion makes clear, the FCC cannot count on future committed entry as a basis for granting forbearance. Future entry will almost certainly not be "timely," since deployment of telecommunications facilities is extremely slow. It is very unlikely that an entrant would be able to deploy facilities broadly enough to have a significant market impact throughout an MSA in two years. Future entry is not "likely" because the factors described herein (lock-up agreements by incumbents, a long history of failed entry by competitors, the need to establish a long track record of high quality service and the incumbents' cost advantages) leave little chance that a competitor will achieve MVS. Future entry will not be "sufficient" because it is unlikely that a competitor could deploy facilities to more than a relatively small subset of locations within an MSA, thereby likely preventing the competitor's offering from disciplining the incumbent's prices.

The FCC's recent track record in relying on predictions of future competition further supports this view. As discussed, in the *Omaha Order*, for example, the FCC eliminated unbundling for loops needed to provide business broadband service based on the prediction that future competition from the cable company would discipline the incumbent LEC's conduct in the wholesale business broadband market.[55] But as McLeodUSA has explained at length, this prediction has not come true.[56] The

[55] *In re Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, Memorandum Opinion and Order, 20 FCC Rcd. 19415, ¶ 67 (2005) ("*Omaha Order*").

[56] Rather than offering reasonable wholesale pricing for DS0, DS1, and DS3 loops, Qwest has only offered McLeodUSA access to Qwest's loop facilities at special access rates. *See* Petition for Modification of McLeodUSA Telecommunications Services, Inc., *In re Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, WC Dkt. No. 04-223, at 4 (filed July 23, 2007) ("McLeodUSA Petition"). These tariffed, special access rates are largely unregulated and substantially higher than cost-based rates for UNEs. According to McLeodUSA, Qwest's "demands include[d] prices increases in the range of 30% or more for monthly charges for DS0 stand alone loops, a minimum increase of 86% for DS1 access loops,

Commission's reliance on future entry in other contexts has been no more reliable. In the *Special Access Pricing Flexibility Order*, the FCC predicted that competitors that establish fiber-based collocations would exert competitive pressure on incumbent LECs' special access services.[57] It is now abundantly clear that this prediction was incorrect.[58] Similarly, in the *TRO*,[59] the *Wireline Broadband Order*,[60] and the *Section 271 Broadband Forbearance Order*,[61] the Commission predicted that broadband over power

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and a 360% increase in associated non-recurring charges for installing DS1 access loops." *Id*. at i. As a result, McLeodUSA publicly announced that it would discontinue its operations in the Omaha MSA if the Commission does not modify the *Omaha Order*. *See id.* at 14 ("The nine affected wire centers represent the vast majority of revenue opportunity of McLeodUSA's current and prospective customer base. Accordingly, McLeodUSA is being forced to exit all Omaha wire centers because there is simply not enough revenue potential in the unaffected Omaha wire centers to justify the ongoing operating costs of the local switching center and related expenses.").

[57] *See In re Access Charge Reform et al.*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd. 14221, ¶ 82 (1999) ("*Special Access Pricing Flexibility Order*") ("For all these reasons, we are confident that, in the past, the presence of an operational collocation arrangement in a wire center almost always implied that a competitor has installed transmission facilities to compete with the incumbent."); *id.* ¶ 84 ("We conclude here that a collocation-based trigger provides an administratively simple and readily verifiable mechanism for determining whether competitive conditions warrant the grant of pricing flexibility."); *id*. ¶ 88 ("Accordingly, we conclude that collocation arrangements are more likely than transport and termination agreements to demonstrate that competitors have invested in facilities sufficiently to resist exclusionary pricing behavior.").

[58] *See generally Special Access Letter* (demonstrating that incumbents' special access rates are much higher than competitors' rates given the same terms and conditions).

[59] *See Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd. 16978, ¶ 263 (2003) ("*TRO*") (subsequent history omitted).

[60] *See In re Appropriate Framework for Broadband Access to the Internet Over Wireline Facilities*, Report and Order and Notice of Proposed Rulemaking, 20 FCC Rcd. 14853, ¶¶ 50, 56-59 (2005) ("*Wireline Broadband Order*"), *aff'd, Time Warner Telecom, Inc. v. FCC*, 507 F.3d 205 (3d Cir. 2007).

[61] *See In re Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c); SBC Communications Inc's Petition for Forbearance Under 47 U.S.C. §*

lines, satellite broadband services, as well as fixed and mobile wireless broadband services would develop into significant competitors in the provision of broadband service. In none of these orders did the FCC attempt to determine how soon these firms could enter the business broadband market or at what price. Not surprisingly, none of the services relied upon for future entry in fact developed into significant competitors to wireline broadband.

In light of the characteristics of the telecommunications markets at issue in UNE forbearance proceedings and the unreliability of past FCC predictions of future entry, it is appropriate for the FCC to establish a presumption that it will not consider potential competition in UNE forbearance proceedings. That presumption should be rebutted only by a persuasive showing that a particular future entrant meets the criteria of likelihood, timeliness and sufficiency in the Guidelines.

Required Level of Actual Competition. While there does not appear to be any basis for relying on future entry as a basis for forbearing from unbundling requirements, the Commission should consider the extent to which existing competition is sufficient to constrain the incumbent LECs' ability to set prices above costs and harm consumer welfare. The question, then, is how much actual competition the Commission should require in a product market to justify forbearance from unbundling requirements.

As discussed, Section 10 permits the FCC to forbear only where the legal requirement in question is no longer necessary either to ensure that rates, terms and conditions are just, reasonable and not unjustly or unreasonably discriminatory or to

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160(c); Qwest Communications International Inc. Petition for Forbearance Under 47 U.S.C. § 160(c); BellSouth Telecommunications, Inc. Petition for Forbearance Under 47 U.S.C. § 160(c), Memorandum Opinion and Order, 19 FCC Rcd. 21496, ¶ 22 (2004) ("*Section 271 Broadband Forbearance Order*").

ensure that consumers are protected from harm post-forbearance. This means that there must be sufficient facilities-based competition that the incumbent cannot, either through unilateral conduct or tacit collusion with one or more competitors, charge prices that significantly exceed a fair measure of cost (e.g., forward-looking costs yielded by TELRIC), degrade service quality or slow-roll innovation. An assessment of the extent of competition under this test must consider the specific characteristics of the market, including, at a minimum (1) an assessment of the number of facilities-based competitors; (2) the extent to which those competitors' networks have already been deployed to all or virtually all of the end user locations in the MSA; (3) the extent to which such competitors have garnered market share; (4) and any evidence that the incumbent possesses substantial and persisting cost advantages as compared to competitors.

There are several guideposts that the FCC should follow in assessing these factors. First, the Commission must at the very least deny forbearance where the incumbent faces only a single facilities-based competitor. As Dr. Besen has explained, numerous theoretical models predict that "duopoly more typically leads to higher prices than would prevail in a market with a larger number of firms and that the entry of additional firms would result in lower prices."[62] Likewise, in empirical studies of various markets and industries (including those with low-entry barriers such as bid auction markets, food retailing, and tires), "a common finding is that the presence of three or more significant competitors tends to result in lower prices than those that prevail in

[62] Declaration of Dr. Stanley M. Besen at 2, attached to Letter from Andrew D. Lipman, Counsel, TDS Metrocom, LLC *et al*. & Thomas Jones, Counsel, Cbeyond, Inc. *et al*., to Marlene H. Dortch, Secretary, FCC, WC Dkt. Nos. 08-24 & 08-49 (filed Apr. 23, 2009) ("*Besen Duopoly Declaration*").

duopoly."[63] Based on these findings, Dr. Besen has concluded that, without conducting more analysis, "the FCC cannot conclude that the presence of only two firms is sufficient to achieve a competitive outcome and they can reasonably presume that the entry of a third firm is likely to result in prices that are closer to competitive levels."[64] Moreover, given that "the presence of a third substantial competitor results in a significant reduction in prices"[65] in markets with *low barriers to entry*, this conclusion is even more likely to be true in markets with *high barriers to entry*, such as the telecommunications markets at issue in UNE forbearance proceedings. Indeed, a number of empirical studies suggest that, in some markets, the presence of a fourth, fifth or additional firms might result in even lower prices, thereby demonstrating that even three substantial firms may not be sufficient to yield competitive pricing.[66]

Chairman Genachowski recently reiterated the market benefits that flow from the presence of more than two competitors. In particular, he noted that, following the PCS auctions that increased the number of CMRS carriers from two to five "there was a drop of 50 percent in the per-minute price of cell phone service, and at the same time the number of subscribers more than tripled."[67] In fact, as Dr. Besen noted, "the FCC itself has recognized that [cellular] duopolies cannot be expected to price competitively and

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[63] *Id*. at 3.

[64] *Id.* at 17.

[65] *Id.* at 8.

[66] *See id.* at 9-10.

[67] *See In re Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions With Respect to Mobile Wireless including Commercial Mobile Services*, Notice of Inquiry, FCC 09-67 (rel. Aug 27, 2009), Statement of Chairman Julius Genachowski at 1, *available at* http://hraunfoss.fcc.gov/edocs_public/attachmatch/FCC-09-67A2.pdf.

that the entry of additional firms could be expected to lead to lower prices."[68] There is no reason to think that wireline markets are any different.

Second, in order to have a constraining effect on the incumbent, it is critical that a facilities-based competitor demonstrate an ability to capture significant market share. For example, as Dr. Besen has explained with regard to the effect of the entry of a third competitor in a duopoly market structure, empirical evidence suggests that while the presence of a third "substantial" firm would reduce the otherwise high price-cost margins of the two leading firms in a duopoly market, "a third firm with only a small market share might have little effect."[69] In fact, one empirical study on the effect of market share distribution on industry price-cost margins has found that the presence of a third firm in a market affects prices once the third firm's market share is greater than or equal to 16 percent.[70] Similarly, evidence developed during the FTC's review of a proposed merger between two retail "superstores" shows that the presence of a third major firm had a moderating effect on prices, but the presence of smaller retail outlets did not.[71] Based on this evidence, Dr. Besen has concluded that "without further analysis, one should not be too quick to count fringe or differentiated players as being fully equivalent to major direct competitors."[72]

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[68] *See Besen Duopoly Declaration* at 11 & n.30 (citing *In re Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Radio Services*, First Report, 10 FCC Rcd. 8844, ¶ 4 (1995)).

[69] *Id.* at 8.

[70] *See id.* n.17.

[71] *See id.* at 14 (citing *FTC v. Staples, Inc.*, 970 F. Supp. 1066, 1078 (D.D.C. 1997)).

[72] *Id.*

Third, the Commission should carefully examine the reach of competitors' networks. Competitors must reach all or virtually all of the locations needed to serve a product market in order to constrain the incumbent LEC because continued reliance on the incumbent's loop facilities will give the incumbent the opportunity to continue to exercise market power by raising its rivals' costs.

To constitute a viable alternative to the incumbent in wholesale loop markets, a competitor must have (1) constructed network facilities sufficient to cover at least 75 percent of the end user locations in an MSA and (2) developed sufficient back-office capabilities. As the Joint Commenters have explained, competitors need to be able to enter downstream retail markets throughout an MSA to achieve minimum efficient scale and the transaction costs associated with relying on more than one wholesale loop provider are prohibitive.[73] As the Joint Commenters have also explained, competitors cannot rely on a loop wholesale provider unless the wholesaler has deployed robust operational support systems ("OSS") needed to efficiently conduct ordering, provisioning, maintenance and repair functions.[74] Thus, in assessing the extent to which the incumbent faces competition in the wholesale market, the Commission should steeply discount the significance of an alternative to the incumbent unless the competitive wholesaler offers customers loop facilities throughout the MSA via a fully operational wholesale OSS.

In the retail market, the Commission need not insist that a competitor has deployed its network to a minimum number of end user locations, since, unlike wholesale

[73] *See* Joint Commenters' April 14th UNE Forbearance Ex Parte Letter at 9-11 & nn.40-48.

[74] *See id.* at 17-18 & n.84.

customers, most categories of retail customers only purchase service at a single location. Instead, the Commission should assess the extent to which multiple non-incumbent LECs offer service over their own loop facilities to each retail customer within the MSA. As a general matter, the Commission should require that at least two non-incumbent LEC competitors reach each retail customer with the non-incumbent LECs' own loop facilities.

The one caveat to these observations regarding retail network coverage concerns multi-location business customers. In a product market in which a significant percentage of the available revenue is associated with multi-location businesses, it is necessary that the competitors' networks reach all of the likely locations in which such businesses are located in the MSA. Otherwise, the incumbent LECs will have the opportunity and incentive to exploit their control over loops serving locations that competitors' networks do not reach by, for example, denying, delaying, degrading or overpricing competitors' access to such loops.

Finally, the Commission should assess the relationship between retail and wholesale markets generally. When examining retail competition, the Commission should examine all of the major downstream retail markets that competitors serve via unbundled loops and transport facilities, including the full range of business services such as DS1 integrated services, Ethernet over copper, and so on. If there is sufficient facilities-based competition to protect customers against prices set substantially above cost in any such retail market (e.g., because of robust competition from multiple intermodal competitors that rely on their own loop facilities), then it makes sense to eliminate unbundling for purposes of serving that particular retail market. Competitors should be permitted to continue to rely on UNEs to serve the downstream retail markets in which there is insufficient competition.

When examining wholesale competition, the Commission should assess the extent to which competitive wholesalers offer substitutes for the unbundled network element facilities themselves. If there is sufficient facilities-based wholesale competition in the provision of any particular unbundled network element or close substitutes for such facilities to prevent wholesalers from charging prices substantially above cost, then the incumbent's obligation to offer the network element in question should be eliminated entirely.

IV. THE FCC SHOULD APPLY ITS NEW STANDARD OF REVIEW TO THE EXISTING FACTUAL RECORD.

The FCC should apply the standard of review it adopts on remand to the existing factual record in the 6-MSA and 4-MSA proceedings. This approach is well within the agency's discretion and is appropriate under the circumstances.

First, an administrative agency is free to make its own judgment as to whether additional fact-gathering is necessary in remand proceedings,[75] and such decisions are subject to the lenient abuse of discretion standard of review.[76] An agency need not

[75] *See, e.g.*, *Sierra Club v. EPA*, 325 F.3d 374, 382 (D.C. Cir. 2003) (citing *Nat'l Grain & Feed Ass'n v. OSHA*, 903 F.2d 308, 310 (5th Cir. 1990)) (applying "the usual rule that a reviewing court should leave the agency free on remand to determine whether supplemental fact-gathering is necessary"); *City of Brookings Mun. Tel. Co. v. FCC*, 822 F.2d 1153, 1171 (D.C. Cir. 1987) ("In remanding this case to the Commission, we leave to its sound discretion to what extent, if any, it should reopen the record to satisfy the concerns we have articulated.") (citing *Bowman Transp., Inc. v. Arkansas-Best Freight System, Inc.*, 419 U.S. 281, 294-95 (1974)).

[76] *See, e.g.*, *E. Carolinas Broad. Co. v. FCC*, 762 F.2d 95, 103 (D.C. Cir. 1985) ("Courts normally reverse an agency's decision not to reopen the record only for abuse of discretion."); *Bowman Transp., Inc.*, 419 U.S. 281 at 294-95.

reopen the record, even in the face of newly available evidence, if the agency determines that such evidence would not affect the final outcome of the proceeding.[77]

The FCC need not reopen the record here. As explained, the incumbent LECs, cable companies and CLECs submitted detailed evidence regarding the extent of facilities-based competition in the ten MSAs at issue in this remand right up to the close of the underlying proceedings. Since that time, it is extremely unlikely that the state of facilities-based competition has changed significantly in any of the ten markets at issue. This is because, as the Commission has found, competitors face substantial barriers to entry in deploying their own loop and transport facilities.[78] As a result, deploying local transmission facilities is a slow and uncertain process. For example, tw telecom likely deploys loop facilities to commercial buildings at a faster pace than any non-incumbent LEC, yet even tw telecom is only able to deploy approximately 1,000 loop facilities per year *in all of its 75 markets combined*.[79] Nor has there been any major technological change that has enabled a new, more efficient means of entry in the relevant markets. It is extremely unlikely that, between the close of the record in the 6-MSA proceeding (December 5, 2007) and the 4-MSA proceeding (July 25, 2008) and the present, competitors have deployed loop or transport facilities in sufficient volumes in any of the ten MSAs to materially change the result of the forbearance analysis.

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[77] *See E. Carolinas Broad. Co.*, 762 F.2d at 103-04.

[78] *See, e.g.*, *TRRO* ¶¶ 150-51 & 153 (describing barriers); *see also id.* ¶ 166 (finding that "competitive deployment of DS3-capacity loops is in some cases economic" and that "competitive deployment of stand-alone DS1-capacity loops is rarely if ever economic").

[79] *See* tw telecom inc., 2008 Annual Report, at 4 (Form 10-K) (filed Feb. 24, 2009) ("In 2008, we extended our fiber network by approximately 1,000 route miles and into approximately 1,100 additional buildings in our markets.").

This is especially true given that the records in the underlying proceedings did not come close to supporting the conclusion that incumbent LECs had lost their ability to exercise market power in any of the MSAs at issue. There was no evidence of wholesale competition in either the business markets or the residential markets. Nor was there any indication that the level of retail competition in the provision of services to business customers from firms that possess their own loop facilities was close to sufficient to constrain the incumbent LECs' market power. As the Commission found, cable company networks do not reach most business customers, CLECs have not been able to deploy loops to more than a tiny percentage of the tens of thousands of commercial buildings in each MSA, and wireless services are not substitutes for wireline retail services offered by competitors via UNEs to business customers.[80] The level of competition in the provision of residential telephone service was substantial as measured by the Commission's standard of review, but that standard of review vastly overstated the extent of competition by including mobile wireless service in the residential wireline telephone market without any basis for doing so. If mobile wireless carriers are excluded from the wireline market, it is clear that competition is insufficient to justify forbearance in that market because, at best, the market is a duopoly.

It is also worth noting that Verizon and Qwest are free to file a new petition for forbearance in any market in which facilities-based competition does develop

[80] *See 6-MSA Order* n.116 ("Most of the cable operators state that their networks are primarily in residential areas and their provision of services to enterprise customers are still in the initial stages"); *id*. ¶ 41 ("Verizon does not provide any comparative data for the number of buildings with demand for high-capacity services or lit buildings that Verizon serves, and the percentage of all commercial buildings that competitors light is extremely small on a relative basis--only 0.25 percent in the 6 MSAs, with the highest percentage in Virginia Beach of only 1.9 percent.").

significantly in the future. As mentioned, Verizon did so for Virginia Beach and Rhode Island and Qwest did so for Phoenix. That Verizon withdrew its petitions seems to reflect its recognition that market conditions have not, after all, changed sufficiently to yield a different result than the FCC reached in the *6-MSA Order* even in the two urban areas in which it believed the level of competition to be the most substantial. Qwest apparently believes that conditions have changed sufficiently in Phoenix to justify forbearance, a case that it has the chance to prove in current proceeding regarding that MSA. The incumbents' opportunity to refile forbearance petitions in this manner in the future further reinforces the reasonableness of declining to re-open the record in this remand proceeding.

Finally, if for some reason the Commission were to conclude that the record in any of the MSAs at issue in this proceeding indicates that competition is substantial in a relevant product market and that it makes sense to refresh the record, it should only reopen the record in those markets. Detailed review of new factual information requires a substantial expenditure of Commission resources. Moreover, producing and analyzing new factual information in forbearance proceedings is extremely expensive and burdensome for competitive carriers. The Commission should not expend its own resources or force others to do the same unless absolutely necessary. Accordingly, the Commission should narrowly tailor any decision to re-open the record to specific product markets in specific MSAs in which the existing record indicates that facilities-based competition is close to constraining the incumbent's exercise of market power.

V. CONCLUSION

The Commission should assess the merits of the ten MSAs at issue in this remand in according with the discussion herein.

Respectfully submitted,
/s/ *Thomas Jones*
Thomas Jones
Jonathan Lechter
Nirali Patel
WILLKIE FARR & GALLAGHER LLP
1875 K Street, N.W.
Washington, D.C. 20006
(202) 303-1000

Attorneys for Cbeyond, Inc., Integra Telecom, Inc., One Communications Corp. and tw telecom inc.

September 21, 2009

ATTACHMENT B

WILLKIE FARR & GALLAGHER LLP

1875 K Street, NW
Washington, DC 20006

Tel: 202 303 1000
Fax: 202 303 2000

VIA ECFS ***EX PARTE***

April 14, 2009

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW, Suite TW-A325
Washington, DC 20554

Re: ***Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island,*** **WC Docket No. 08-24;** ***Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in Cox's Service Territory in the Virginia Beach Metropolitan Statistical Area,*** **WC Dkt. No. 08-49**

Dear Ms. Dortch:

On March 26, 2009, a coalition of competitors, including One Communications Corp., tw telecom inc., Integra Telecom, Inc., and Cbeyond, Inc., filed in the above-referenced dockets a proposed standard for FCC consideration of incumbent LEC petitions for forbearance from unbundling obligations.[1] On behalf of One Communications Corp., tw telecom inc., Integra Telecom, Inc., and Cbeyond, Inc., please find attached a paper that provides factual and legal support for the proposed standard.

Please do not hesitate to contact me if you have any questions with respect to this submission.

Respectfully submitted,

/s/ Thomas Jones
Thomas Jones
Jonathan Lechter
Nirali Patel

Attorneys for One Communications Corp., tw telecom inc., Integra Telecom, Inc., and Cbeyond, Inc.

Attachments

[1] *See* Letter from Andrew D. Lipman et al., Counsel for Alpheus Communications, L.P. et al. to Marlene H. Dortch, Secretary, FCC, *In re Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island*, WC Dkt. No. 08-24; *In re Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in Cox's Service Territory in the Virginia Beach Metropolitan Statistical Area*, WC Dkt. No. 08-49 (filed Mar. 26, 2009).

cc: Nick Alexander
Scott Deutchman
Jennifer Schneider
Mark Stone
Randy Clarke
Marcus Maher
Tim Stelzig
Don Stockdale
Julie Veach

FACTUAL AND LEGAL SUPPORT FOR COMPETITORS' PROPOSED UNE FORBEARANCE STANDARD

On March 26, 2009, a coalition of competitors[1] proposed a new standard (hereinafter "Proposed Standard")[2] for FCC (or "Commission") consideration of incumbent local exchange carrier ("incumbent LEC" or "ILEC") petitions for forbearance from the unbundling requirements of Section 251(c)(3)[3] of the Communications Act of 1934, as amended (the "Act").[4] The Proposed Standard is as follows:

> Petitions for forbearance from Section 251(c)(3) unbundling obligations filed pursuant to Section 10 of the Act[5] shall be considered on a Metropolitan Statistical Area ("MSA") basis. In determining what level of competition in the MSA is sufficient under Section 10, the Commission should determine, for each MSA in which forbearance is sought, whether there are
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> (1) at least two facilities-based non-ILEC wireline competitors in the wholesale loop market, each of which has actually deployed end-user connections to 75 percent of end-user locations, each of which has deployed wholesale operations support systems sufficient to support the wholesale demand in the relevant product market, and each of which has garnered at least 15 percent of wholesale loop market share in the relevant product market ("Wholesale Test");
>
> or
>
> (2) at least 75 percent of end-user locations are served by two or more facilities-based non-ILEC wireline competitors that offer retail service in the relevant downstream product market to the locations in question via loops that the competitors have actually deployed, and there are at least two facilities-based

[1] This coalition includes, among other companies, Cbeyond, Inc. ("Cbeyond"), Integra Telecom, Inc. ("Integra"), One Communications Corp. ("One Communications"), and tw telecom inc. ("tw telecom") (collectively, the "Joint Commenters").

[2] *See* Letter from A. Lipman et al., Counsel for Alpheus Communications, L.P. et al. to Marlene H. Dortch, Secretary, FCC, *In re Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island*, WC Dkt. No. 08-24; *In re Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in Cox's Service Territory in the Virginia Beach Metropolitan Statistical Area*, WC Dkt. No. 08-49 (filed Mar. 26, 2009).

[3] *See* 47 U.S.C. § 251(c)(3) (imposing on incumbent LECs the duty to provide "nondiscriminatory access to network elements on a unbundled basis at any technically feasible point on rates, terms, and conditions that are just, reasonable, and nondiscriminatory").

[4] *See generally* Communications Act of 1934, as amended by the Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996).

[5] 47 U.S.C. § 160(c).

> competitors to the ILEC that have each garnered at least 15 percent of retail market share in the relevant product market ("Retail Test").
>
> In extraordinary circumstances, the FCC may depart from this standard and reach a different conclusion as to whether to grant or deny a petition for forbearance from unbundling obligations than would otherwise apply under this standard.

This paper provides factual and legal support for the Proposed Standard. Specifically, Part I of this paper explains why the FCC's existing analytical framework for considering petitions for forbearance from unbundling obligations is flawed and must be replaced. Part II explains the logic underlying the salient features of the Proposed Standard. Finally, Part III applies the Proposed Standard to Verizon's pending petition for forbearance from unbundling obligations in Rhode Island.[6]

I. PROBLEMS WITH THE ANALYTICAL FRAMEWORK THE FCC HAS USED TO REVIEW INCUMBENT LEC UNE FORBEARANCE PETITIONS.

In previous orders addressing ILEC petitions for forbearance from unbundling requirements, the FCC has failed to conduct a coherent competition and consumer welfare analysis in several ways. *First*, the FCC has failed to utilize appropriate and consistent geographic markets. For instance, the FCC has examined network coverage on a wire center basis in its unbundled network element ("UNE") forbearance orders. In the *Omaha Order*, the FCC granted forbearance in those wire centers where, among other things, Cox's voice-enabled cable plant covered at least 75 percent of the end-user locations that were accessible from those wire centers.[7] But in other contexts, the FCC has concluded that competitors' entry occurs on a much larger geographic scale than wire centers, such as MSAs. For example, the Commission considers requests for special access pricing flexibility on an MSA basis because it has found that "MSAs best reflect the scope of competitive entry, and therefore, are a logical basis for measuring the extent of competition."[8] Competitive local exchange carriers ("CLECs"), the purchasers of loop and transport facilities, therefore demand those facilities in a much larger geographic area than wire centers.[9] As explained in Part II.A, if a competitor cannot obtain loop

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[6] *See* Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island, WC Dkt. No. 08-24 (filed Feb. 14, 2008).

[7] *See*, *e.g.*, *In re Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, Memorandum Opinion and Order, 20 FCC Rcd. 19415, ¶ 62 (2005) ("*Omaha Order*"); *see also Wireline Competition Bureau Discloses Cable Coverage Threshold in Memorandum Opinion and Order Granting Qwest Corporation Forbearance Relief in the Omaha Metropolitan Statistical Area*, Public Notice, 22 FCC Rcd. 13561, DA 07-3376, at 2 (2007) ("*Cable Coverage Threshold Disclosure Public Notice*") (disclosing 75-percent network coverage threshold).

[8] *In re Access Charge Reform et al.*, Fifth Report and Order and Further Notice of Proposed Rulemaking, 14 FCC Rcd. 14221, ¶ 72 (1999) ("*Pricing Flexibility Order*").

[9] *See infra* Part II.A.

or transport facilities throughout the area necessary to achieve minimum viable scale, the competitor may not be able to sustain its presence in the market, even in the wire centers where UNEs are available.

Second, the FCC has failed to conduct a separate assessment of the extent of competitors' network deployment in different relevant product markets. Most obviously, the FCC has not distinguished between residential and business markets. Instead, it has examined the extent to which competitors have deployed loop facilities to 75 percent of *all* end-user locations, without distinguishing between business and residential end-user locations. That is, the Commission has relied on aggregate data regarding cable network coverage for both residential and business customers[10] even though aggregate data offers no reliable indication of a cable operator's network coverage for either the circuits demanded by residential customers or those demanded by business customers. As a result, the FCC granted forbearance throughout nine Qwest wire centers in the Omaha MSA and five wire centers in the Anchorage study area even though it was not at all clear that the incumbent cable provider's network covered 75 percent of the *business* end-user locations in those wire centers.[11]

Third, the FCC has failed to assess market share separately in relevant product markets. Most obviously, the Commission has failed to account separately for market share in the residential and business markets. Instead, the Commission has examined residential market share only and essentially relied on competitors' success in that market as the basis for predicting that competitors will achieve the same level of success in the business market. In the *Omaha Order*, the Commission predicted that "in light of the record evidence of Cox's strong success in the mass market . . . Cox poses a substantial threat to Qwest for higher revenue enterprise services as well."[12] There was no evidence in the record, however, that Cox was serving *business* customers that demand high-capacity loop and transport facilities to any significant degree. In fact, the FCC ignored retail business market share evidence submitted into the record by Cox and never analyzed Cox's actual retail market share for business customers served by the high-capacity loop and transport facilities at issue. Moreover, in contravention of its prediction, the FCC had already acknowledged that many cable companies had captured more than fifty percent of the residential broadband customers across the country without achieving similar success in the business market, especially among those customers served by high-capacity loops.[13]

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[10] *See, e.g., Omaha Order* ¶ 69; *see also In re Petition of ACS Anchorage, Inc. Pursuant to Section 10 of the Communications Act of 1934, as amended, for Forbearance from Section 251(c)(3) and 252(d)(1) in the Anchorage Study Area*, Memorandum Opinion and Order, 22 FCC Rcd. 1958, ¶ 32 (2007) ("*Anchorage Order*").

[11] *See id.*

[12] *Omaha Order* ¶ 66.

[13] *See In re Petition for Forbearance of the Verizon Tel. Cos. Pursuant to 47 U.S.C. § 160(c); SBC Communications Inc.'s Petition for Forbearance Under 47 U.S.C. § 160(c) et al.*, Memorandum Opinion and Order, 19 FCC Rcd. 21496, ¶ 22 & n.68 (2004).

There are several additional reasons why the FCC's reliance on cable companies' success in the mass market to predict future success in the business market is unreliable. To begin with, cable companies have benefited from several advantages in the residential market that they do not benefit from in the business market. These advantages include the following: (1) legacy relationships with residential customers in the provision of subscription video services; (2) economies of scope in the provision of IP voice services to residential customers; and (3) the ability to deploy end-user connections to essentially all residential customers at a time when cable companies enjoyed a protected (*de facto* or *de jure*) monopoly in the provision of subscription video services. As a result, even the most optimistic analysts predict that cable will achieve no more than 25 percent market share in the small business market.[14]

The FCC's reliance on facilities-based competitors' (namely, cable providers') success in the mass market to predict success in the business market is also flawed because the products and services offered by such competitors may not meet the demands of business customers. As the Joint Commenters have explained in their filings in several UNE forbearance proceedings, businesses generally do not view cable company offerings as substitutes to the DS0, DS1, and DS3-based services offered by CLECs,[15] and as the Commission itself has recognized, cable operators' "provision of services to enterprise customers are still in the initial stages."[16]

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[14] *See* Insight Research Corporation, *Cable Telephony: The Threat to Small Business ILEC Markets, 2007-2012*, Executive Summary, at 6 (rel. April 2007) (stating that cable operators will penetrate 25 percent of the total small enterprise market between 2007 and 2012); *see also* Raymond James & Associates, Inc., *Telecommunications Services Wireline Industry Report: Examining the Convergence of the Telecom and Cable Sectors*, at 9 (rel. Aug. 18, 2008) (stating that Comcast management is targeting a 20 percent share of the small and medium business market over the next several years).

[15] *See, e.g.,* Joint Opposition of Time Warner Telecom, Cbeyond, and Eschelon Telecom, *In re Petitions of Qwest Corp. for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis, St. Paul, Phoenix and Seattle MSAs*, WC Dkt. No. 07-97, at 31 (filed Sept. 13, 2007) ("As Richard Batelaan, Cbeyond's Chief Operating Officer, explains in his declaration, while Cbeyond faces competition from both ILECs and other facilities-based CLECs that rely on UNEs in the [small and medium enterprise] market, 'Cbeyond faces little, if any, facilities-based competition from cable operators or wireless companies.'"); *see id.* Attachment C, Declaration Of Richard J. Batelaan On Behalf Of Cbeyond, Inc., ¶ 5.

[16] *In re Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach MSAs*, Memorandum Opinion and Order, 22 FCC Rcd. 21293, n.116 (2007) ("*6-MSA Order*"). In addition, mobile wireless carriers do not appear to provide an effective substitute for residential wireline voice service. In a November 2008 report on the state of competition in the telecommunications industry, for example, the Department of Justice observed that "more than 80 percent of residential customers do not consider mobile wireless to be a substitute for a landline telephone at current access prices, since they continue to pay for and use both." U.S. Department of Justice, *Voice, Video and Broadband: The Changing Competitive Landscape and Its Impact on Consumers*, at 66 (Nov. 2008), *available at* http://www.usdoj.gov/atr/public/

Nor has the Commission conducted a meaningful analysis of competition in the wholesale market. Instead, the FCC has simply assumed that competition in the downstream retail market from a single intermodal facilities-based competitor would give the incumbent LEC the incentive to offer competitors access to the incumbent LEC's loops and transport on just and reasonable terms and conditions. Specifically, in the *Omaha Order*, the FCC predicted that competition in the mass market from Cox would prevent Qwest from curtailing wholesale access to its loop and transport facilities:

> [t]he very high levels of retail competition that do not rely on Qwest's facilities – and for which Qwest receives little to no revenue – [will] provide Qwest with the incentive to make attractive wholesale offerings available so that it will derive more revenue indirectly from retail customers who choose a retail provider other than Qwest.

Omaha Order ¶ 67; *see also id.* ¶¶ 79-81. But the FCC has never attempted to determine whether there is any factual basis for this prediction. In fact, McLeodUSA Telecommunications' experience in the post-forbearance Omaha market indicates that the FCC's prediction was erroneous. Rather than offering reasonable wholesale pricing for DS0, DS1, and DS3 loops, Qwest has only offered McLeodUSA access to Qwest's loop facilities at special access rates.[17] As a result, McLeodUSA publicly announced that it would discontinue its operations in the Omaha MSA if the Commission does not modify the *Omaha Order*.[18] Moreover, as a direct consequence of McLeodUSA's difficulty in negotiating reasonable "commercial" pricing for voice-grade and high-capacity loops from Qwest, Integra abandoned its plans to enter the Omaha MSA.[19]

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reports/239284.pdf. But in all events, there would be no basis for predicting that wireless carriers can offer an effective replacement for *business* wireline voice and data services.

[17] *See* Petition for Modification of McLeodUSA Telecommunications Services, Inc., *In re Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Omaha Metropolitan Statistical Area*, WC Dkt. No. 04-223, at 4 (filed July 23, 2007) ("McLeodUSA Petition"). These tariffed, special access rates are largely unregulated and substantially higher than cost-based rates for UNEs. According to McLeodUSA, Qwest's "demands include[d] prices increases in the range of 30% or more for monthly charges for DS0 stand alone loops, a minimum increase of 86 % for DS1 access loops, and a 360% increase in associated non-recurring charges for installing DS1 access loops." *Id*. at i.

[18] *See* McLeodUSA Petition at 14 ("The nine affected wire centers represent the vast majority of revenue opportunity of McLeodUSA's current and prospective customer base. Accordingly, McLeodUSA is being forced to exit all Omaha wire centers because there is simply not enough revenue potential in the unaffected Omaha wire centers to justify the ongoing operating costs of the local switching center and related expenses.").

[19] Comments of Integra Telecom, Inc., *In re Petitions of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Boston, New York, Philadelphia, Pittsburgh, Providence and Virginia Beach Metropolitan Statistical Areas,* WC Dkt. No. 06-172, at 4-5 (filed Mar. 5, 2007).

In the subsequent *Anchorage Order*, the FCC required petitioner ACS to offer loop facilities in the Anchorage study area at rates equivalent to those negotiated between ACS and the incumbent cable operator, GCI, in the Fairbanks, Alaska market until parties negotiated separate rates for Anchorage.[20] The Commission imposed this rate regulation or "competitive backstop"[21] as a condition of granting forbearance *precisely because* of arguments made by McLeodUSA regarding its inability to obtain loops and transport at reasonable rates in the Omaha market. Specifically, the Commission held that "[w]e believe this condition adequately addresses issues raised by McLeodUSA."[22] The FCC thus implicitly acknowledged that it erred in simply assuming that competition in the downstream retail market from a single cable operator would give Qwest the incentive to offer competitors in Omaha access to its loops and transport at rates that are low enough to allow CLECs to continue to compete. Yet, the Commission has never explicitly disavowed the predictive judgment it made in the *Omaha Order*.

Fourth, the FCC has failed, in general, to ensure that forbearance does not yield a post-forbearance duopoly in which the incumbent LEC and cable operator have the incentive and ability to sustain prices at supra-competitive levels. As mentioned above, in the *Anchorage Order*, the FCC implicitly conceded that granting forbearance from unbundling in a market in which only one non-ILEC competitor has deployed its own loops on a widespread basis would lead to a duopoly and unreasonably high wholesale rates for loops.[23] The FCC therefore conditioned its grant of forbearance on ACS' continued obligation to offer loops in Anchorage at the rates it charged under a commercial agreement that applied in Fairbanks.[24] The Fairbanks rates were approximately 2 percent and 19 percent higher than UNE rates for DS1 and DS0 facilities, respectively, in Anchorage.[25] Unfortunately, the FCC has failed to recognize that it is simply inappropriate to grant forbearance in a market where only a single competitor has deployed loop facilities to most end-user locations.

Fifth, in assessing the extent of facilities-based competition, the FCC has incoherently characterized as "facilities-based competitors" those competitors that rely on unbundled loops sold by incumbent LECs as well as those competitors that rely on resale. For example, while the

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[20] *Anchorage Order* ¶ 39.

[21] *Id.* ¶ 41.

[22] *Id.* n.134.

[23] *See id.* ¶¶ 40-42; *see also id.* ¶ 46 ("While we recognize . . . that most of the competition in the Anchorage study area comes from two competitors, the continuing obligation of ACS to provide unbundled access to loops at rates, terms and conditions under mutually agreeable rates, terms, and conditions – with an interim agreement no less favorable than that reached by ACS and GCI in Fairbanks – with [sic] permit other competitors to enter the market, thereby reducing the risk of anticompetitive conduct.").

[24] *See id.* ¶ 39.

[25] *See id.* n.133.

Commission explicitly found that there were no significant alternative sources of wholesale inputs for carriers in the Omaha market, it held that "Qwest's own wholesale offerings will continue to be adequate without unbundled loop and transport offerings."[26] In making this determination, the Commission relied in part on Qwest's offering of unbundled network element-platform ("UNE-P") replacement products.[27] Specifically, the Commission took into account the number of "residential [Qwest Platform Plus ("QPP")] arrangements (*i.e.*, combinations of DS0 loops, switching, and shared transport)"[28] as well as the number of "business QPP arrangements."[29] But the Commission cannot logically rely on competition that, by definition, relies on an incumbent LEC's unbundled loops as a basis for eliminating the very same unbundled loops.[30] And while the FCC subsequently held in the *6-MSA Order* that "competition that relies on Verizon's own facilities is *not* a sufficient basis to grant forbearance from UNE requirements,"[31] it nevertheless included "competitive lines provisioned via Qwest's UNE-P replacement service in [its] market share calculations" for facilities-based competitors in the *4-MSA Order*.[32]

As it did in the *Omaha Order*,[33] the Commission also treated resale-based competition as equivalent to facilities-based competition in the *4-MSA Order*.[34] But resale-based competition

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[26] *Omaha Order* ¶ 67.

[27] *See id.* ¶¶ 67-68.

[28] *Id.* ¶ 67; *see also* Petition of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area, WC Dkt. No. 07-97, n.23 (filed Apr. 27, 2007) ("QPP/QLSP includes unbundled loops").

[29] *Omaha Order* ¶ 68.

[30] It is also worth noting that, just as the availability of UNEs constrains special access pricing (as the Commission explicitly recognized in the *TRRO* (*In re Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Order on Remand, 20 FCC Rcd. 2533, ¶¶ 64-65 (2004) and the *6-MSA Order* (¶ 42)), the availability of DS0 unbundled loops constrains the price of UNE-P replacement products that include DS0 unbundled loops (such as Qwest's QPP/QLSP products and Verizon's "Wholesale Advantage" product). Because these products combine UNE loops and non-UNE switching and transport, if the ILEC were to significantly increase the price of the UNE-P replacement product, such an increase may provide prospective purchasers with an incentive to purchase only DS0 unbundled loops and supply their own switching capability instead.

[31] *6-MSA Order* ¶ 42 (emphasis added).

[32] *In re Petitions of Qwest Corp. for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis, St. Paul, Phoenix and Seattle MSAs*, Memorandum Opinion and Order, 23 FCC Rcd. 11729, n.64 (2008) ("*4-MSA Order*").

[33] *See Omaha Order* ¶¶ 67-68.

[34] *See 4-MSA Order* n.64.

cannot be included in the Commission's calculation of competitors' market share because it is also competition that relies on the incumbent LEC's own facilities.

Moreover, resale-based competition is qualitatively different from, and yields far fewer consumer benefits than, UNE-based competition. To begin with, resellers have essentially no ability to innovate by offering new services because they can only offer the services already made available by the incumbent LEC.[35] By contrast, UNE-based competitors can combine incumbent LEC loop or transport facilities with their own electronics to provide new and higher quality services such as integrated access DS1-based services. In addition, the "'retail-less-discount'" pricing of resale provides no constraint on incumbent LEC prices because higher incumbent LEC prices yield higher wholesale prices.[36] Thus, there is no basis for the FCC to include resale-based competition or competition that relies on UNEs in its forbearance analysis.

This flawed existing forbearance framework is likely to cause the FCC to grant petitions where the Section 10 standard is not met (*i.e.*, false positives) and even to deny petitions in some markets in which the Section 10 standard is met (*i.e.*, false negatives). The possibilities for false positive and false negative outcomes are legion, but some illustrative examples are as follows:

- **Example one.** By measuring competitors' network coverage for all end users without distinguishing between residential and business customers, the existing standard can yield the conclusion that there is sufficient network coverage in the business market when in fact there is not (*i.e.*, the high percentage of residential end-user locations covered masks the low percentage of business end-user locations covered). This conclusion can, in turn, cause the FCC to grant forbearance in the business market where there is insufficient competition to protect consumers and competition absent the availability of UNEs.

- **Example two.** By relying on the presence of a single facilities-based competitor as the basis for a speculative prediction that a wholesale market will develop for local

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[35] *See, e.g., In re Implementation of the Local Competition Provisions in the Telecommunications Act of 1996; Interconnection Between Local Exchange Carriers and CMRS Providers*, First Report and Order, 11 FCC Rcd. 15499 ¶ 332 (1996) ("*Local Competition Order*") (finding that "carriers reselling incumbent LEC services are limited to offering the same service an incumbent offers at retail"); *see also* Gillan Associates, "The Irrelevance of Resale and RBOC Commercial Offers to Competitive Activity in Local Markets," May 2008, *In re Petitions of Qwest Corp. for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis, St. Paul, Phoenix and Seattle MSAs*, WC Dkt. No. 07-97, at 2 (filed May 15, 2008) ("Gillan Resale White Paper") (stating that "resale is nothing more than the re-offering of the retail service as designed by the incumbent" and that "[t]here is no meaningful ability for the purchasing carrier (that is, the reseller) to differentiate its product from that offered by the incumbent through innovation").

[36] *See* Gillan Resale White Paper at 2 ("[R]esellers can never impose a competitive constraint on the incumbent's prices . . . because the wholesale price moves up with any increase in the retail price. Consequently, the ILEC is able to simultaneously raise its rivals' costs in lock-step with any desired retail rate increase, effectively ensuring that rivals match – and, therefore, reinforce – the incumbent's rate increases.").

transmission facilities, the existing forbearance standard can cause the FCC to eliminate the only viable wholesale offers (*i.e.*, UNEs) for transmission facilities in a market. The result is a post-forbearance duopoly.

II. THE LOGIC UNDERLYING THE PROPOSED STANDARD FOR FCC REVIEW OF INCUMBENT LEC UNE FORBEARANCE PETITIONS.

The objective of the Proposed Standard is to remedy the flaws in the FCC's prior UNE forbearance orders while at the same time establishing a stable and generally predictable framework for the consideration of UNE forbearance petitions. The Proposed Standard accomplishes this goal by, among other things, (1) using a stable relevant geographic area (*i.e.*, MSAs) that is firmly rooted in an analysis of the competitive effects of eliminating access to UNEs; (2) allowing for distinct consideration of certain categories of products (*e.g.*, between wholesale and retail products and between products demanded by business customers and residential customers) while allowing for the possibility of further disaggregation by product type; and (3) allowing forbearance to be granted only where it is likely that the incumbent LEC will face meaningful competition from multiple (*i.e.*, at least two) competitors in a product market throughout the MSA.

A. Identifying The Relevant Geographic Area Under The Proposed Standard.

In formulating a new UNE forbearance standard, the FCC must first establish a stable and administrable geographic area for purposes of assessing UNE forbearance petitions. For transmission services in the telecommunications industry, the FCC has recognized that each point-to-point connection technically constitutes a separate geographic market.[37] Nevertheless, the Commission has recognized that "assessing market power in each individual point-to-point market would be administratively impractical and inefficient."[38] Therefore, the Commission has held that it is reasonable to aggregate point-to-point markets in certain circumstances.[39] Accordingly, where the competitive effects of eliminating regulation applicable to point-to-point circuits (such as the duty to provide UNE loops and transport facilities) would be felt in a broad geographic area, it is appropriate for the FCC to use that broader geographic area to analyze competition for purposes of determining whether it should retain the regulation.

In the case of the duty to provide UNEs, the competitive effects of eliminating such regulation would extend throughout greater metropolitan areas—areas that are most effectively

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[37] *See, e.g., In re Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area et al.*, Second Report and Order in CC Docket No. 06-149 and Third Report and Order in CC Docket No. 96-61, 12 FCC Rcd. 15756, ¶ 5 (1997) ("*LEC Classification Order*" or "*LEC In-Region Interexchange Order*") ("We define the relevant geographic market for interstate, domestic, long distance services as all possible routes that allow for a connection from one particular location to another particular location (*i.e.*, a point-to-point market).").

[38] *See id.* ¶ 66.

[39] *See id.*

captured by MSA boundaries. CLECs that purchase wholesale inputs to provide downstream retail services can generally achieve minimum viable scale only if they serve geographic areas that are roughly the size of an MSA or at least the size of an MSA. For example, One Communications determines the boundaries of the geographic areas it will serve based on several factors, including the minimum number of business locations that it must serve in order to recover the substantial fixed costs associated with market entry and to ultimately achieve profitability.[40] As explained by One Communications' Executive Vice President of Strategy, Russell Oliver, other factors include "not only the locations of businesses and office parks and the proximity of fiber and central offices to those businesses and office parks but the amount of driving time it takes for One Communications' sales associates and network engineers to reach customers, and the ability of those personnel to use the highway system to meet with customers and maintain One Communications' network."[41] One Communications has found that MSAs tend to reflect these driving and communications patterns.[42] In addition, many of One Communications' small and medium-sized business customers have multiple locations which are generally all located within the same MSA.[43] Based on its analysis of these factors, One Communications has determined that, "at a minimum, it must be able to serve the small and medium-sized businesses in approximately 70 to 80 percent of wire centers in an MSA in order to achieve profitability."[44] As a result, One Communications generally serves "areas that roughly approximately MSAs rather than subsets of MSAs."[45]

Similarly, according to Cbeyond's Chief Marketing Officer, Brooks Robinson, Cbeyond has found that in order to recover the substantial sunk costs associated with market entry and ultimately achieve profitability, its "network footprint in a geographic area must contain at least 30,000 locations associated with businesses between 5 and 249 employees."[46] It is also important that each of Cbeyond's serving areas are large and contiguous so that Cbeyond can, among other things, serve customers with multiple locations and implement its sales model, which is based on face-to-face consultations and field visits with existing and potential business

[40] *See* Declaration of Russell Oliver on Behalf of One Communications Corp., ¶ 5 ("Oliver Declaration") (attached hereto as Attachment A).

[41] *Id.* ¶ 6.

[42] *Id.*

[43] *Id.* ¶ 5.

[44] *Id.* ¶ 7.

[45] *Id.* ¶ 8.

[46] Declaration of Brooks Robinson on Behalf of Cbeyond, Inc., ¶ 6 ("Robinson Declaration") (attached hereto as Attachment B).

customers.[47] As a result, "Cbeyond must serve an area that is at least the size of a Metropolitan Statistical Area."[48]

Accordingly, it makes sense to use a geographic area, such as an MSA, that is larger than a wire center to assess network coverage.[49] Significantly, the FCC *has* used MSAs as the geographic area for measuring *market share* in UNE forbearance proceedings.[50] In other contexts, the FCC has sensibly used the same geographic market to measure network coverage and market share.[51] Thus, the Commission should do the same in UNE forbearance proceedings.

For all of these reasons, the Proposed Standard utilizes MSAs as the relevant geographic area in which to assess UNE forbearance petitions. Under the Proposed Standard, incumbent LECs would be required to seek forbearance from Section 251(c)(3) unbundling requirements in one or more MSAs. Incumbent LECs would not be allowed to deviate from utilizing MSAs as the relevant geographic area except in extraordinary circumstances.

B. Identifying Relevant Product Markets Under The Proposed Standard.

The FCC must also establish stable and administrable product markets for purposes of assessing UNE forbearance petitions. To begin with, it is important for the FCC to recognize that the retail and wholesale markets constitute separate product markets. The Commission has already implicitly acknowledged the importance of doing so in wireline merger orders by conducting separate analyses of the market for wholesale special access services[52] as distinct

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[47] *Id.* ¶ 6.

[48] *Id.*

[49] While the Joint Commenters have argued in the past that a wire center was sufficient as a geographic market for assessing network coverage, they have reassessed their position in light of the need for competitors to achieve minimum viable scale in order to enter a geographic area.

[50] *See, e.g., 4-MSA Order* ¶ 27 ("The record evidence does not reflect that *in any of the four MSAs* do the cable operators, even in the aggregate, have more than a [REDACTED] percent share of the market for mass market telephone services *in an MSA*.") (emphasis added); *see also 6-MSA Order* ¶ 37 ("the record evidence indicates that competition from cable operators *in the 6 MSAs* currently does not present a sufficient basis for relief") (emphasis added).

[51] *See, e.g., In re Motion of AT&T Corp. To Be Reclassified As A Non-Dominant Carrier*, Order, 11 FCC Rcd. 3271, ¶¶ 22, 57-62, 67-72 (1995) (using "'a single national relevant geographic market[]'" to assess market share and supply elasticity in the interstate domestic, interexchange services market) (internal citation omitted); *In re Applications of Nextel Communications, Inc. and Sprint Corporation For Consent to Transfer Control of Licenses and Authorizations*, Memorandum Opinion and Order, 20 FCC Rcd. 13967, Appendix C ("*Sprint-Nextel Merger Order*") (analyzing both market share and network coverage in "seven specific markets of potential concern" on a Basic Trading Area ("BTA") basis).

[52] *See In re SBC Communications Inc. and AT&T Corp. Applications for Approval of Transfer of* Control, Memorandum Opinion and Order, 20 FCC Rcd. 18290, ¶¶ 24-55 (2005) ("*SBC-AT&T*

from the downstream services for which such wholesale services are inputs.[53] In other contexts, such as assessments of competitive market conditions in the satellite industry, the Commission has also implicitly and explicitly acknowledged the significance of examining competition in wholesale and retail product markets separately.[54] Moreover, international regulators have also expressly held that a distinction should be made between retail and wholesale markets in assessing market power.[55]

This approach is justified in UNE forbearance proceedings because of the stark differences between wholesale and retail markets. The wholesale products at issue are stand-alone voice-grade DS0 loops, conditioned copper loops, DS1 loops, DS3 loops as well as DS1 and DS3 transport. The retail products at issue are the downstream services provided *via* these wholesale facilities, a set of products that ranges from telephone services to xDSL broadband services to Ethernet services. The absence of sufficient competition in the provision of

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Merger Order"); *In re Verizon Communications Inc. and MCI, Inc. Applications for Approval of Transfer of Control*, Memorandum Opinion and Order, 20 FCC Rcd. 18433, ¶¶ 24-55 (2005) ("*Verizon-MCI Merger Order*"); *In re AT&T Inc. and BellSouth Corp. Application for Transfer of Control*, Memorandum Opinion and Order, 22 FCC Rcd. 5662, ¶¶ 27-33 (2007) ("*AT&T-BellSouth Merger Order*").

[53] *See, e.g.*, *SBC-AT&T Merger Order* ¶¶ 56-80 (analyzing competitive effects of the proposed merger on retail enterprise services); *Verizon-MCI Merger Order* ¶¶ 56-81 (same); *AT&T-BellSouth Merger Order* ¶¶ 62-87 (same).

[54] *See In re Second Annual Report and Analysis of Competitive Market Conditions with Respect to Domestic and International Satellite Communications Services*, Second Report, 23 FCC Rcd. 15170, ¶¶ 28-29 (2008) ("differentiat[ing] the relevant product markets between wholesale and retail markets" and analyzing competition "in an aggregated market for domestic wholesale satellite services"); *In re Annual Report and Analysis of Competitive Market Conditions with Respect to Domestic and International Satellite Communications Services*, First Report, 22 FCC Rcd. 5954, ¶ 33 (2007) ("We examine several relevant markets, including 'wholesale' (in which the product is capacity, an input to a service provided to business or retail consumers) and 'retail' (in which the product is a service provided to consumers)."); *In re Constellation, LLC et al., Transferors and Intelsat Holdings, Ltd., Transferee, Consolidated Application for Authority to Transfer Control of PanAmSat Licensee Corp. and PanAmSat H-2 Licensee Corp.*, Memorandum Opinion and Order, 21 FCC Rcd. 7368, ¶¶ 31-33 (2006) ("Finally, it is useful to contrast the nature of competitive rivalry in *retail* satellite service markets, where customers are ordinary consumers buying, for example, multi-channel video programming services, and wholesale satellite service markets, where customers are business entities buying video transmission services by satellite for either contribution or distribution purposes. . . . Given the significant structural and behavior differences between retail and wholesale satellite services markets, different models of competitive rivalry apply.") (emphasis in original).

[55] *See European Commission guidelines on market analysis and the assessment of significant market power under the Community regulatory framework for electronic communications networks and services*, 2002 Official Journal of the European Communities (C 165/03), ¶ 67.

wholesale services does not preclude the possibility that there is competition in the provision of downstream retail services, because downstream competitors often do not offer their transmission facilities at wholesale. Conversely, the absence of competition in the downstream retail market does not preclude the possibility that there is competition in the provision of upstream wholesale inputs, because providers of loop and transport facilities might not compete in the provision of one or more of the relevant downstream retail products.

Accordingly, under the Proposed Standard, the FCC would separately assess the wholesale and retail markets. When applying the Wholesale Test of the Proposed Standard, the FCC would examine the relevant markets for wholesale loop inputs. That is, the FCC would assess the extent to which competitors with their own loop and transport facilities offer at wholesale substitutes for unbundled DS0 loops, conditioned copper loops, DS1 loops, DS3 loop, DS1 transport, and DS3 transport facilities. When applying the Retail Test of the Proposed Standard, the FCC would examine the relevant markets for retail services that are provided using UNE loop inputs. That is, the FCC would assess the extent to which competitors with their own loop and transport facilities use those facilities to offer substitutes for downstream retail services that competitors provide *via* UNEs. Such downstream retail services include, for example, voice service, xDSL service, and Ethernet service.

Furthermore, within the retail market, the FCC should recognize the inherent differences in services demanded by and sold to residential customers and small business customers. *First*, competitors' practices for marketing and advertising to small business customers are different than would be the case if they sought to acquire residential customers.[56] Service providers targeting residential customers rely on mass marketing to offer various service plans and bundles that are not generally customizable.[57] As explained in the attached declarations by high-level executives at One Communications and Integra, however, both companies rely on direct sales representatives to conduct face-to-face consultations and on-site visits with prospective business customers—even the smallest business customers—to proactively determine their telecommunications needs and design individualized solutions to meet those needs.[58]

Second, competitors such as One Communications and Integra provide more proactive and personalized customer service to their business customers than they would if they served residential customers. For instance, One Communications and Integra dedicate account managers to every customer with an average monthly bill of at least $500, and those account managers proactively contact customers multiple times per year to assess their ongoing

[56] *See* Declaration of Randy Ritter & Jill Fritz on Behalf of One Communications Corp., ¶ 4 ("Ritter-Fritz Declaration") (attached hereto as Attachment C); Declaration of Steve Anderson & Jason Mocca on Behalf of Integra Telecom, Inc., ¶ 4 ("Anderson-Mocca Declaration") (attached hereto as Attachment D).

[57] *See* Ritter-Fritz Declaration ¶ 5; Anderson-Mocca Declaration ¶ 5.

[58] *See* Ritter-Fritz Declaration ¶ 5; Anderson-Mocca Declaration ¶ 5.

communications needs.[59] Even the smallest business customers (*i.e.*, those with average monthly bills under $500) demand a level of care that is superior to that demanded by residential customers.[60] In particular, businesses of all sizes generally demand that service problems be detected and resolved more quickly and efficiently than residential customers.[61] Therefore, One Communications and Integra employ enough call center employees to ensure average call speeds that are faster than would be the case for residential customers, and they maintain certain practices to provide personalized customer care even in the call center environment.[62] Carriers such as One Communications and Integra also employ numerous operating practices to proactively monitor their networks and detect and resolve service problems in shorter repair intervals.[63]

Third, competitors that serve only business customers must design their networks differently than would be the case if they served residential customers. As explained by executives in One Communications' and Integra's engineering and operations departments, carriers must allocate more capacity on the shared portions of their telephone and data networks to accommodate business customers' higher usage levels.[64] These companies must also build higher levels of redundancy in their networks to meet even the smallest business customers' demands for greater reliability and lower tolerance for service outages.[65]

Fourth, the service features and characteristics demanded by and marketed to even the smallest business customers are qualitatively different from those demanded by and marketed to

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[59] *See* Ritter-Fritz Declaration ¶¶ 9-10; Anderson-Mocca Declaration ¶¶ 9-10. These companies provide this level of service for each location of a business customer that meets the average monthly bill threshold, even those locations to which they provide only basic telephone service. *See id.* ¶ 10.

[60] *See* Ritter-Fritz Declaration ¶ 12; Anderson-Mocca Declaration ¶ 12

[61] *See* Declaration of David Charbonneau & Aaron Bruneau on Behalf of One Communications Corp., ¶ 10 ("Charbonneau-Bruneau Declaration") (attached hereto as Attachment E); Declaration of Dave Bennett & Steve Fisher on Behalf of Integra Telecom, Inc., ¶ 9 ("Bennett-Fischer Declaration") (attached hereto as Attachment F).

[62] *See* Ritter-Fritz Declaration ¶ 12; Anderson-Mocca Declaration ¶ 12 ("For example, in Oregon, Integra assigns a subset of its call center employees directly to customer accounts under $500 in certain circumstances, such as when a customer has been experiencing ongoing service problems.").

[63] *See* Charbonneau-Bruneau Declaration ¶¶ 10-15 (explaining that, among other things, One Communications conducts "remote testing, monitoring, and troubleshooting for all of its business customers, including its smallest business customers"); Bennett-Fisher Declaration ¶¶ 9-13.

[64] *See* Charbonneau-Bruneau Declaration ¶¶ 6-7; Bennett-Fisher Declaration ¶ 6.

[65] *See* Charbonneau-Bruneau Declaration ¶ 8; Bennett-Fisher Declaration ¶ 7.

residential customers. The voice service offerings available to small business and residential customers reflect this difference in demand.[66] For example, based on research conducted by One Communications' Director of Pricing Strategy and Product Operations, Daniel Hewitt, and Integra's Vice President of Product Development and Marketing, Trent Anderson, service providers offer certain calling features to small business customers that they either do not offer or do not market on their websites to residential customers.[67] These include call hunting, call transfer, and remote call forwarding.[68]

Likewise, the features of the data services offered to small businesses are qualitatively different from the features of data services offered to residential customers.[69] As explained by Messrs. Hewitt and Anderson, service providers typically offer features with their Internet access service for small businesses that are designed to increase such businesses' productivity and efficiency and offer increased security and reliability.[70] By contrast, service providers tend to offer residential customers features that enable residential customers to, among other things, view and share photos, videos, games, music, and other entertainment content.[71]

Fifth, according to Mr. Anderson, "[t]he differences in the levels of customer service and the features offered to residential and small business customers are reflected in the prices of these services."[72] For instance, the prices of voice service plans for small businesses are generally higher than voice service plans for residential customers that include a similar number or fewer number of features.[73] Providers also often charge significantly higher rates for basic broadband services provided to small business customers than those provided to residential customers, even for service at the same maximum download speeds.[74]

These higher prices are unsurprising given that carriers serving business customers, including the smallest business customers, incur substantial costs in the areas of customer

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[66] *See* Declaration of Daniel Hewitt on Behalf of One Communications Corp., ¶ 6 ("Hewitt Declaration") (attached hereto as Attachment G).

[67] *See id.* ¶ 6; Declaration of Trent Anderson on Behalf of Integra Telecom, Inc., ¶ 6 ("T. Anderson Declaration") (attached hereto as Attachment H).

[68] *See* Hewitt Declaration ¶ 6; T. Anderson Declaration ¶ 6.

[69] *See* Hewitt Declaration ¶ 5; T. Anderson Declaration ¶ 5.

[70] *See* Hewitt Declaration ¶ 5; T. Anderson Declaration ¶ 5.

[71] *See* Hewitt Declaration ¶ 5; T. Anderson Declaration ¶ 5.

[72] T. Anderson Declaration ¶ 8.

[73] *See* Hewitt Declaration ¶ 8; T. Anderson Declaration ¶ 8.

[74] *See* Hewitt Declaration ¶ 8; T. Anderson Declaration ¶ 8.

acquisition,[75] network design and engineering,[76] and customer care[77] that they likely would not incur if they served residential customers. According to Messrs. Hewitt and Anderson, because of the differences in the telephone and Internet access service offerings available to residential and business customers, and the way in which these services are marketed, it is unlikely that small business customers would switch to residential telephone and Internet access services if providers increase the prices of small business telephone and Internet access services.[78] In light of all of these differences, under the Proposed Standard, basic voice and broadband services sold to residential customers belong to different product markets than voice and broadband services sold to small business customers.

The Proposed Standard does not foreclose further disaggregation of product markets. In certain circumstances, it may well make sense for the FCC to differentiate among the products sold to residential customers and among the products sold to business customers. This would be the case, for example, where levels of competition among the products offered to business customers are significantly different, and a petitioner for forbearance has demonstrated that competition in the MSA for one or more wholesale or retail products sold to business customers is near the threshold established in the Proposed Standard.

C. Identifying Competitors For Purposes Of The Proposed Standard.

It is critical that the FCC establish clear criteria for identifying the firms that should be "counted" as competitors under the Proposed Standard. Under the Wholesale Test and the Retail Test, a facilities-based non-ILEC competitor must be a *wireline* competitor in order to qualify as a competitor because mobile wireless voice and data services are not substitutes for wireline voice and data services. As the Joint Commenters have explained at length in their filings in several UNE forbearance proceedings, mobile wireless voice service does not belong in the same product market as residential wireline telephone service.[79] But even if mobile wireless service

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[75] *See* Ritter-Fritz Declaration ¶ 8; Anderson-Mocca Declaration ¶ 8.

[76] *See* Charbonneau-Bruneau Declaration ¶ 9; Bennett-Fisher Declaration ¶ 8.

[77] *See* Charbonneau-Bruneau Declaration ¶ 17; Bennett-Fisher Declaration ¶ 14; Ritter-Fritz Declaration ¶¶ 11-12; Anderson-Mocca Declaration ¶¶ 11-12.

[78] *See* Hewitt Declaration ¶¶ 5-6; T. Anderson Declaration ¶¶ 5-6.

[79] *See, e.g.,* Letter from T. Jones, Counsel for One Communications Corp. et al., to Marlene H. Dortch, Secretary, FCC, *In re Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island*, WC Dkt. No. 08-24, at 7-9 (filed Dec. 3, 2008) ("Joint Commenters' December 3, 2008 Rhode Island *Ex Parte* Letter"); Letter from T. Jones, Counsel for Cbeyond, Inc., et al., to Marlene H. Dortch, Secretary, FCC, *In re Petitions of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis-St. Paul, Phoenix, and Seattle Metropolitan Statistical Areas*, WC Dkt. No. 07-97, at 2-10 (filed May 7, 2008); *see generally* K. Mikkelsen, "Mobile Wireless 'Cut the Cord' Households in FCC Analysis of Wireline Competition," Apr. 21, 2008, *In re Petitions of Qwest Corporation for*

belongs in the same product market as wireline service marketed to residential customers, no petitioner for forbearance from unbundling obligations has ever shown that there is any basis for concluding that mobile wireless voice service belongs in the same product market as wireline voice service marketed to *business* customers.[80] Moreover, no such petitioner has demonstrated that there is any basis for concluding that mobile wireless *data* services belong in the same product market as residential wireline data services, let alone business wireline data services.

Furthermore, under the Wholesale Test of the Proposed Standard, each facilities-based non-ILEC wireline competitor must have *actually deployed* end-user connections to 75 percent of the relevant end-user locations in an MSA. This network coverage requirement is necessary because, as explained in the attached Oliver and Robinson Declarations, in order for CLECs such as One Communications and Cbeyond to rely on a wholesale provider of loops, the provider must generally be able to serve all of the locations that One Communications and Cbeyond provide service.[81] According to Messrs. Oliver and Robinson, this is because the transaction costs associated with establishing and maintaining multiple wholesale relationships are generally too high for their companies to rely on multiple wholesale loop providers in a given geographic area.[82]

In addition, under the Wholesale Test, each facilities-based non-ILEC wireline competitor must have deployed wholesale operations support systems ("OSS"), including systems that allow for electronic bonding, to accommodate the wholesale demand in the relevant product market. As the Commission has held in the past, sufficiently developed OSS is essential to the availability of wholesale offerings.[83] Moreover, as explained by Messrs. Oliver and Robinson, in order for One Communications and Cbeyond to rely on a wholesale provider of loops, the provider must have fully developed OSS such that they can accomplish ordering,

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Forbearance Pursuant to 47 U.S.C. § 160(c) in the Denver, Minneapolis, St. Paul, Phoenix and Seattle MSAs, WC Dkt. No. 07-97 (filed Apr. 22, 2008).

[80] Notably, as explained by Broadview Networks et al., Verizon has failed to include mobile wireless services as a source of competition in the business market in its pending forbearance petitions. *See* Letter from G. Morelli, Counsel for Broadview Networks et al., to Marlene H. Dortch, Secretary, FCC, *In re Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island*, WC Dkt. No. 08-24 et al., n.16 (filed Apr. 3, 2009) (citing Verizon Rhode Island Petition at 26-30 and Verizon Virginia Beach Petition at 26-31).

[81] *See* Oliver Declaration ¶ 10; Robinson Declaration ¶ 9.

[82] *See* Oliver Declaration ¶ 10; Robinson Declaration ¶ 8.

[83] *See, e.g., Local Competition Order* ¶ 516 (finding that OSS is essential to promote viable competitive entry); *see id.* ¶ 518 ("Much of the information maintained by these systems is critical to the ability of other carriers to compete with incumbent LECs using unbundled network elements or resold services.").

provisioning, monitoring, maintenance, repair and billing in a timely and cost-effective manner.[84]

Under the Retail Test, at least 75 percent of end-user locations must be served by two or more facilities-based non-ILEC wireline competitors using loops that the competitors have actually deployed. This network coverage requirement takes into account the demand patterns of retail customers and ensures that most retail customers have at least two competitors from which to purchase service in the relevant product market.

Finally, under both the Wholesale Test and the Retail Test, each competitor must have captured at least 15 percent of the market share in the relevant product market. This market share requirement ensures that a competitor in the relevant product market is a viable competitor that has achieved some modest success among the relevant customers.

D. Under The Proposed Standard, Forbearance Would Only Be Granted Where The Incumbent LEC Faces Competition From *At Least Two* Qualifying Competitors In The Relevant Product Market.

It is critical that the FCC deny forbearance where the post-forbearance market structure would be a duopoly. Otherwise, there is a substantial risk that prices in post-forbearance markets would be set at supra-competitive levels.[85] This conclusion is firmly rooted in antitrust law and principles. Moreover, supra-competitive prices would result in dead-weight losses to consumer welfare.[86] For this reason, under the Proposed Standard, forbearance would not be granted in a market unless and until two sufficiently viable facilities-based competitors have entered the market.

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[84] *See* Oliver Declaration ¶ 9; Robinson Declaration ¶ 7.

[85] *See* PHILIP E. AREEDA, ET AL., ANTITRUST LAW ¶ 925(c) (2d ed. 2006) ("*Areeda 2d ed*.") ("On almost every assumption about the type of oligopoly behavior, price increases to levels significantly above cost are highly likely in such markets. Thus, significant mergers in such markets would bear a strong presumption of illegality. Markets reducing the number of 'significant' firms from four to three, or from five to four, typically fall into this classification.").

[86] Even the presence of three competitors in many instances does not produce prices that would prevail in a fully competitive market. In fact, in many markets, six to ten competitors are necessary to achieve that result. *See Areeda 2d ed.* ¶ 927(a) ("[O]ne reasonable and fairly general conclusion is that noncompetitive pricing in a market for a homogeneous product is unlikely to occur when there are more than six to ten equivalent sellers. . . . This would be the equivalent of a[n] [HHI] reading in the 1000-1800 range . . . . By contrast, when the HHI exceeds 1800[,] . . . the danger of noncompetitive pricing is likely to increase."). Therefore, the Proposed Standard, which eliminates the incumbent LECs' duty to provide UNEs only if there are three facilities-based wireline competitors in a market, is conservative because a grant of forbearance based on the existence of three competitors in a market does not necessarily eliminate the risk that prices would remain above competitive levels.

1. Antitrust Doctrine Condemns Mergers To Duopoly In Markets With Similar Characteristics As The Markets At Issue In The Rhode Island Forbearance Proceeding.

Merger analysis conducted under antitrust law is a helpful guide to assessing the effects of different market structures on prices because antitrust law is the main vehicle by which the government analyzes the harms arising from market concentration, including duopoly.[87] The economics of merger analysis teach that the harms arising from concentrated markets cannot be measured mechanically from the application of one theory or another. For this reason, courts, as well as the FTC and FCC, examine the overall harms that may result from market concentration to determine whether governmental intervention is appropriate. Nevertheless, it is analytically useful to consider two ways in which a post-forbearance duopoly market structure would make it more likely that supra-competitive prices would result: (1) through the unilateral conduct of one or both of the remaining market players; or (2) through coordinated interaction of the two remaining market players.

a. Unilateral Conduct

There is a substantial risk that an incumbent LEC could unilaterally increase prices to supra-competitive levels in many or most markets in which the incumbent LEC receives forbearance in a market in which it faces only a single facilities-based competitor.[88] The *DOJ-FTC Horizontal Merger Guidelines* state that there is an increased likelihood of unilateral price increases once a merged firm selling a homogenous product obtains at least a 35 percent market share and other market characteristics indicate that non-merging firms could not expand output sufficiently to frustrate an effort to increase prices.[89] The conditions facilitating unilateral conduct are clearly met in Rhode Island if Verizon is left to compete against a single facilities-based competitor.

First, if the relevant Rhode Island markets are served by a facilities-based duopoly, it is a mathematical certainty that one firm, if not both firms, will exceed the 35 percent market share threshold. For example, Verizon could have 80 percent market share in a particular market and the second provider could have 20 percent market share. In that case, Verizon would retain an overwhelmingly dominant share of the market, increasing the risk that Verizon would

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[87] In a subsequent filing, the Joint Commenters will submit a declaration from economists which discusses in more detail the harms to consumer welfare likely to occur in duopoly markets.

[88] *See* U.S. Department of Justice and Federal Trade Commission, Horizontal Merger Guidelines § 0.1 (Apr. 2, 1992, revised Apr. 8, 1997) ("*DOJ-FTC Horizontal Merger Guidelines*") ("Circumstances also may permit a single firm, *not a monopolist,* to exercise market power through unilateral or non-coordinated conduct--conduct the success of which does not rely on the concurrence of other firms in the market or on coordinated responses by those firms.") (emphasis in original).

[89] *See DOJ-FTC Commentary on the Horizontal Merger Guidelines*, at 26-27 (Mar. 2006), *available at* http://www.usdoj.gov/atr/public/guidelines/215247.pdf ("*DOJ-FTC Commentary*").

unilaterally raise prices.[90] If Verizon had 55 percent market share and the other facilities-based competitor had 45 percent market share, both firms would meet the 35 percent threshold, increasing the risk that Verizon *and* the other firm would act unilaterally to raise prices.

Second, the products sold by Verizon and competitors in Rhode Island are homogenous. Cox's consumer cable modem and Verizon's consumer DSL service provide essentially the same features at similar prices: asymmetrical broadband Internet access service without service level agreements.[91] Moreover, Cox markets its consumer voice service as just as reliable and feature rich as the incumbent LEC's phone service.[92] Verizon's and its competitors' business transmission services (*i.e.*, DS1 and DS3) are even more homogenous. DS1 and DS3 services are based on defined standards established decades ago by Bell Labs.[93] These services offer set bandwidths (1.544 Mbps for a DS1 and 44.736 Mbps for a DS3) and fixed feature sets. For example, a DS1 always contains 28 64-kbps channels that can be utilized for voice or data.[94]

Third, given the substantial barriers to entry, it is unlikely that other firms would be able to quickly enter or rapidly expand capacity on an MSA-wide basis to prevent the two remaining firms from unilaterally increasing their prices. As the FCC, DOJ, and GAO have found, this is

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[90] The FCC has often looked to market share as a primary indicator of whether a firm is dominant and therefore able to unilaterally raise prices. *See* 47 C.F.R. § 61.3(q) (defining a "dominant carrier" as "[a] carrier found by the Commission to have market power (*i.e.*, power to control prices)"). All other things being equal, the higher a firm's market share, the more likely it will be able to unilaterally increase prices. *See In re Matter of Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor*, First Report and Order, 85 F.C.C.2d 1, ¶ 62 (1980) ("AT&T, including its 23 associated telephone companies and its Long Lines Department, dominates the telephone market by any method of classification. Currently, the Bell System controls access to over 80% of the nation's telephones. Since many of AT&T's competitors must have access to this network if they are to succeed, AT&T possesses control of bottleneck facilities. Therefore, we believe that AT&T must be treated as dominant.").

[91] *See* Attachment 1 to Hewitt Declaration.

[92] *See* Cox Communications, http://ww2.cox.com/residential/rhodeisland/phone/answers-about-phone.cox (last visited Apr. 6, 2009) ("What is Cox phone service? Cox phone is the same primary line telephone service you've known for years inside your home. Cox owns and operates a privately managed network to send and receive calls."); *see id*. (discussing standard features of Cox's residential phone service).

[93] *See* NEWTON'S TELECOM DICTIONARY 273 (20th ed. 2004) (explaining the origins of the DSx standard and the capacities of DS0, DS1, and DS3 services).

[94] *See id.*

particularly true with respect to the market for business transmission services (*i.e.*, DS1s and DS3s), in which facilities-based entry is extremely difficult.[95]

b. Coordinated Interaction

If forbearance were granted based on the presence of only a single facilities-based competitor to the incumbent LEC, there is an increased risk that the incumbent LEC and the competitor will engage in coordinated action to charge supra-competitive prices. It is well established that high market concentration can facilitate express or tacit collusion (or "coordination" or "coordinated interaction") to increase prices to supra-competitive levels.[96] To begin with, a smaller number of competitors can more easily negotiate and sustain consensus on price, output, and other terms.[97] Fewer competitors can also more readily detect and punish

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[95] *See TRRO,* ¶¶ 148-154 (finding that it is almost always uneconomical for competitive carriers to deploy DS1s or DS3s); *see also* Government Accountability Office, Report to the Chairman, Committee on Government Reform, House of Representatives, *FCC Needs to Improve Its Ability to Monitor and Determine the Extent of Competition in Dedicated Access Services*, GAO-07-08, at 12 (Nov. 2006) (finding that competitive providers deployed facilities to only six percent of commercial buildings with demand of a DS1 or greater and 15 percent of commercial buildings with a DS3 of demand or greater in the 16 markets studied); Compl., *United States v. SBC Communications, Inc. and AT&T Corp.*, No. 1:05-CV-02102, ¶ 15 (D.D.C. Oct. 27, 2005) (finding that "[f]or the vast majority of commercial buildings in its territory, SBC [now AT&T] is the only carrier that owns a last-mile connection to the building"); Compl., *United States v. Verizon Communications Inc. and MCI, Inc.*, No. 1:05-CV-02103, ¶ 15 (D.D.C. Oct. 27, 2005) (finding that "[f]or the vast majority of commercial buildings in its territory, Verizon is the only carrier that owns a last-mile connection to the building").

[96] *See* PHILIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW § 9.05a (3d ed. Supp. 2006) ("[T]here is general agreement that an undue reduction in the number of competing sellers or undue concentration of sales in the hands of a few relatively large sellers is likely to lead to noncompetitive pricing, either through recognized interdependence or actual collusion or both."). It should be noted that the terms of coordination "need not be perfect." *DOJ -FTC Commentary* at 19. For example, coordinated interaction can "yield elevated prices short of monopoly levels . . . and still result in significant competitive harm." *DOJ-FTC Horizontal Merger Guidelines* § 2.11. Modern economic theory shows that what is often characterized as "tacit collusion" need not involve coordinated expectations or threats of *punishment* for deviations, merely a recognition that firms will respond to price initiatives. *See* Eric Maskin and Jean Tirole, *A Theory of Dynamic Oligopoly, I: Overview and Quantity Competition With Large Fixed Costs*, 56 ECONOMETRICA 543, 553 (1988).

[97] *See, e.g., DOJ-FTC Commentary* at 20 ("The number of rival firms remaining after a merger, their market shares, and market concentration are relevant factors in determining the effect of a merger on the likelihood of coordinated interaction. The presence of many competitors tends to make it more difficult to achieve and sustain coordination on competitive terms and also reduces the incentive to participate in coordination"); *see also* Andrew R. Dick, *Coordinated Interaction: Pre-Merger Constraints and Post-Merger Effects*, 12 GEO. MASON L. REV. 65, 71 (2003); RICHARD A. POSNER, ANTITRUST LAW 63 (2d ed. 2001).

deviations from the terms of coordination, thereby increasing the likelihood of successful coordination.[98] It follows that the elimination of actual or potential competitors (*i.e.*, those that rely on UNEs) as a result of forbearance "will make it at least incrementally easier for the remaining suppliers to collude."[99]

While market concentration is likely the most significant factor that facilitates coordination among competitors, other factors also increase the likelihood of coordinated interaction. While the presence or absence of any particular characteristic is not dispositive, among the many market conditions that may facilitate coordination are as follows: (1) the firms' pricing information is readily available;[100] (2) the firms' products and services are homogenous or "standardized";[101] and (3) the market(s) at issue have high entry barriers.

It is likely that these factors are present in most, if not all, of the Rhode Island product markets at issue. *First*, pricing information is readily available from both incumbent LECs and competitors. As indicated by Attachment 1 to the Hewitt Declaration, incumbent LECs' and competitors' prices for residential broadband and voice service are readily available from their respective websites. Similarly, with respect to the business market, Verizon's DS1 and DS3 prices are listed in public tariffs. *Second*, as explained above, the incumbent LECs' and competitors' products sold to business and residential customers are relatively "homogenous" or standardized. *Third*, as discussed above, there are high barriers to entry in the consumer broadband and business transmission markets, making MSA-wide entry difficult.

2. The FCC, DOJ, And The Courts Have Found That Duopolies Often Result In Substantial Competitive Harms And Supra-Competitive Prices.

The FCC, DOJ, and the courts have all recognized that, at a minimum, three facilities-based competitors are necessary to prevent the harms resulting from potential unilateral or collusive conduct in duopoly markets. The FCC has observed that "existing antitrust doctrine

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[98] *See, e.g.,* Dick at 71-72; *see also* POSNER at 63.

[99] Dick at 72.

[100] *See, e.g., DOJ-FTC Commentary* at 18 ("Coordination on prices tends to be easier the more transparent are rivals' prices . . . ."); Dick at 84.

[101] *See, e.g., DOJ-FTC Horizontal Merger Guidelines* § 2.1; AREEDA & HOVENKAMP, ANTITRUST LAW ¶ 404(c)(3) (3d ed. 2007) ("Product complexity, differentiation, or variety greatly impedes oligopolistic coordination[]" because "they multiply avenues of rivalry and hence the decisions that must be coordinated."); Dick at 75 (explaining that the more differentiated products are, the more difficult it will be to punish deviations from the terms of coordination "because suppliers will need to cut their price drastically in order to force a given sized reduction in a cheater's sales"); *see also* POSNER at 76 ("The absence of . . . pricing manuals is also . . . evidence that the industry is producing a custom product in the sense relevant to the feasibility of collusion.").

suggests that a merger to duopoly or monopoly faces a strong presumption of illegality."[102] For this reason, the FCC rejected the proposed transaction to combine the two major DBS providers in the United States, EchoStar and DirectTV, into a single entity.[103] In the *DirecTV-EchoStar Merger Order,* the Commission further recognized that courts "have generally condemned mergers that result in duopoly. . . ."[104] Similarly, the DOJ and FCC found that the cellular duopoly in the mid-1980s to mid-1990s resulted in prices substantially above competitive levels.[105] This conclusion was shared by many leading academics.[106] In addition, prices

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[102] *In re Application of EchoStar Communications Corporation et al.*, Hearing Designation Order, 17 FCC Rcd 20559, ¶ 103 (2002) ("*DirecTV-EchoStar Merger Order*") (citing IV PHILLIP E. AREEDA, HERBERT HOVENKAMP & JOHN L. SOLOW, ANTITRUST LAW, ¶ 932 at 160 (Rev. ed. 1998)) ("No merger threatens to injure competition more than one that immediately changes a market from competitive to monopolized.").

[103] *See generally DirecTV-EchoStar Merger Order.*

[104] *Id.* ¶ 100; *see id.*, n.305 (citing *FTC v. H.J. Heinz Co.*, 246 F.3d 708 (D.C. Cir. 2001)) ("In *FTC v. H.J. Heinz Co.*, [the appeals court] rejected the district court's finding that the merger of the second and third largest firms in a three-firm baby-food market would increase the ability of the merged firm to compete with the number one firm. Noting the district court's finding that 'there had been no significant entries in the baby-food market in decades and that new entry was 'difficult and improbable,' the court of appeals stated that '[a]s far as we can determine, no court has ever approved a merger to duopoly under similar circumstances.'").

[105] *See* Statement of Anne K. Bingaman, Assistant Attorney General, Antitrust Division, United States Department of Justice, Submitted to the Subcommittee on Oversight and Investigations, United States House of Representatives, On Competition in the Cellular Telephone Service Industry, Oct. 12, 1995, at 3 *available at* http://www.usdoj.gov/atr/public/testimony/0460.htm ("Economic theory and experience teach that markets with only two competitors and legal barriers preventing additional entry will result in only limited competition. This is consistent with the Department's experience in the wireless markets. The Department has consistently voiced strong concerns over the cellular duopoly structure -- even before this structure was created. We continue to believe that the markets for wireless telephone service, as controlled by the cellular duopolists in each area, are not fully competitive and that these markets need additional wireless service providers in order to become adequately competitive."); *In re Implementation of Section 6002(B) of the Omnibus Budget Reconciliation Act of 1993 Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Services*, Report, 10 FCC Rcd 8844, ¶ 4 (1995) ("The duopoly nature of cellular service made it less than fully competitive[]. Therefore, in the early 1990s, the Commission allocated 143 MegaHertz ('MHz') of spectrum, almost three times the spectrum allocation for cellular service, to create Personal Communications Services ('PCS'). . . . [T]he Commission's [broadband PCS] spectrum allocation [also] provides sufficient spectrum to ensure at least three, and possibly as many as six, new competitors to the cellular carriers in each market.").

[106] *See, e.g.,* Heli Koski & Tobias Kretschmer, *Regulation and Market Evolution in 2G Telecommunications Markets: Some Observations,* 49 COMMUNICATIONS & STRATEGIES NO. 67,

remained stable as cellular industry costs declined, a recognized indicator of the exercise of market power.[107] The arrival of multiple PCS competitors in the mid-1990s substantially reduced prices closer to competitive levels.[108]

Likewise, the FCC has repeatedly held that fully functioning, competitive markets require at least three *facilities-based* competitors of relatively equal size to prevent public interest harms in retail and wholesale markets. *First*, in the *AT&T Non-Dominance Order*, the FCC found that elimination of dominant carrier regulation for AT&T's long distance service was appropriate because there were a total of three facilities-based carriers with substantial networks (*i.e.*, MCI, AT&T and Sprint) in the market.[109] *Second*, in the *AT&T-Cingular Merger Order*, the FCC held that "the [proposed] transaction would almost certainly be harmful to competition if it resulted in a reduction in the number of rival carriers from 2 to 1, or 3 to 2."[110] *Third*, in the *Sprint-Nextel Merger Order*, the FCC approved the merger and found that "there are no [Component

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75 (2003) ("The wireless duopoly has resulted in substantially higher average prices. In fact, in 1995 the average peak call prices in monopolistic markets were lower than in duopoly markets. Previous work . . . suggests that the presence of two competitors in the market may not reduce prices as much as competition between more than two firms."); *see also* Harald Gruber, *Competition and innovation: The diffusion of mobile telecommunications in Central and Eastern Europe*, 13 INFORMATION ECONOMICS AND POLICY 19, 32 (2001) ("The present study provides further support for the view that more than two firms may be needed to significantly accelerate the diffusion of mobile telecommunications.").

[107] *See* HARALD GRUBER, THE ECONOMICS OF MOBILE TELECOMMUNICATIONS 203 (2005) ("Prices remained remarkably constant in nominal terms over the second half of the 1980[s], in spite of technological developments that led to general reductions in cost. Other studies confirm that at that time duopoly market structure gave little incentives to lower prices.").

[108] *See In re Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993 et al.*, Fifth Report, 15 FCC Rcd 17660, at 18-19 (2000) ("As the Commission observed in the previous two reports, it is difficult to identify sources of information that track mobile telephone prices in a comprehensive manner. However, a number of reports and other available data indicate that the entrance of new competitors into this market continues to reduce prices. Because these studies use different methodologies and market samples, their findings vary and are comparable only in the broadest terms. Nevertheless, they clearly show that the average price of mobile telephony has fallen substantially since the *Fourth Report*, continuing the trend of the last several years.").

[109] *See AT&T Non-Dominance Order* ¶¶ 140-42.

[110] *In re Applications of AT&T Wireless Services, Inc. and Cingular Wireless Corporation et al.*, Memorandum Opinion and Order, 19 FCC Rcd 21522, ¶ 193 (2004) ("*AT&T-Cingular Merger Order*").

Economic Areas] in which the merger would reduce the number of competitors to two or fewer, a merger consequence that [it] would view as presenting a likelihood of competitive harm."[111]

For these reasons, it is sound policy to deny forbearance in markets where the incumbent LEC faces only a single facilities-based competitor. Accordingly, under the Proposed Standard, an incumbent LEC would only be eligible for forbearance in a market in which two or more facilities-based competitors offer substitute services to those offered by the incumbent.[112]

III. THE PROPOSED STANDARD APPLIED TO VERIZON'S RHODE ISLAND FORBEARANCE PETITION.

It is not possible to apply the Proposed Standard fully to the instant forbearance petition without access to confidential network coverage and market share data from the incumbent cable operator in Rhode Island, Cox.[113] However, even without such information, it is clear that Verizon's petition for forbearance in Rhode Island should be denied under the Proposed

[111] *Sprint-Nextel Merger Order* ¶ 119.

[112] If the FCC decides to grant forbearance based on the presence of a single facilities-based competitor, it is critical that the FCC establish appropriate post-forbearance regulations to ensure that the public interest is not harmed. The Commission should follow the logic of its *Anchorage Order* and impose conditions on forbearance grants, as needed, to limit the likelihood that consumers would be required to pay supra-competitive prices post-forbearance. Specifically, the FCC should establish a presumption that, in any MSA in which forbearance is granted based on the presence of a single facilities-based competitor, the FCC will condition its grant of forbearance on the incumbent LEC's continued obligation to offer unbundled loops at rates subject to meaningful post-forbearance rate regulation. Such rate regulation would apply to both RBOCs and incumbent LECs that are not RBOCs. *See Anchorage Order* ¶ 39 ("Until such a commercial agreement is reached, we require ACS to provide loop access at the same rates, terms, and conditions negotiated between ACS and GCI in Fairbanks, Alaska for loop and subloop access."); *see id.* n.133 ("Under the terms agreed to between ACS and GCI, the rate in Fairbanks for a DS0 loop is $23.00 (compared to the Anchorage UNE rate of $18.64), and the rate for a DS1 loop is $87.93 (compared to the Anchorage UNE rate of $86.23).").

[113] The Joint Commenters will submit a more complete analysis of Verizon's pending Rhode Island forbearance petition under the Proposed Standard after Cox submits network coverage and market share data in the record. The Joint Commenters will also submit an analysis of Verizon's pending petition for forbearance in Cox's service territory in the Virginia Beach MSA (*see* Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in Cox's Service Territory in the Virginia Beach Metropolitan Statistical Area, WC Docket No. 08-49 (filed Mar. 31, 2008)) under the Proposed Standard after Cox submits the relevant network coverage and market share data in WC Dkt. No. 08-49. In light of the upcoming May 15, 2009 statutory deadline for the Commission to act on Verizon's Rhode Island forbearance petition, however, Joint Commenters have limited the instant discussion to Rhode Island.

Standard.[114] *First*, Verizon could not demonstrate that the Wholesale Test is satisfied. There is no basis for concluding that Cox could be one of the two required facilities-based non-ILEC wireline competitors in the wholesale loop market because there is no evidence that Cox has sufficient OSS to support the wholesale demand in the relevant product market. Indeed, One Communications' Executive Vice President of Strategy, Russell Oliver, has stated that he is "not aware of any non-incumbent ILEC provider of wholesale loop facilities in Rhode Island that has deployed sufficient OSS capabilities to enable One Communications to rely on that wholesale provider to offer downstream retail services."[115] Moreover, even if Cox qualified as one of the two competitors required to satisfy the Wholesale Test, there is no evidence that there is a second facilities-based non-ILEC wireline competitor in Rhode Island that meets the criteria of the Wholesale Test.

Second, Verizon could not demonstrate that the Retail Test of the Proposed Standard is satisfied. There is no basis for concluding that 75 percent of end-user locations in Rhode Island are served by two facilities-based non-ILEC *wireline* competitors in any of the downstream retail product markets. Accordingly, Verizon's petition for forbearance in Rhode Island should be denied.

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[114] The FCC need not address Verizon's failure to file its petitions for forbearance in Rhode Island and Virginia Beach on an MSA basis because, as Joint Commenters have explained, there is ample basis for rejecting those petitions on other grounds. *See generally* Opposition of One Communications Corp. et al., *In re Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island*, WC Dkt. No. 08-24 (filed Mar. 28, 2008); Opposition of Cbeyond, Inc. et al., *In re Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in Cox's Service Territory in the Virginia Beach Metropolitan Statistical Area*, WC Dkt. No 08-49 (filed May 13, 2008); Joint Commenters' December 3, 2008 Rhode Island *Ex Parte* Letter. In the future, however, the FCC should reject as facially deficient incumbent LEC UNE forbearance petitions that are not filed on an MSA basis, absent extraordinary circumstances justifying a different approach.

[115] Oliver Declaration ¶ 9.

ATTACHMENT C

April 23, 2009

VIA ECFS ***EX PARTE***

Marlene H. Dortch
Office of the Secretary
Federal Communications Commission
445 12th Street, SW
Suite TW-A325
Washington, DC 20554

Re: ***Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island*, WC Dkt. No. 08-24; *Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in Cox's Service Territory in the Virginia Beach Metropolitan Statistical Area*, WC Dkt. No. 08-49**

Dear Ms. Dortch:

The undersigned parties, by their counsel, hereby submit the attached Declaration of Dr. Stanley M. Besen ("Declaration") in which Dr. Besen explains that the theoretical and empirical literature support a presumption that duopolists will *not* price competitively and that the entry of a third firm of substantial size will result in prices that are closer to competitive levels. Dr. Besen's analysis provides further support for the proposed standard for FCC consideration of UNE forbearance petitions submitted by a group of competitive carriers in the above-referenced proceedings on March 26, 2009.[1] The undersigned parties will discuss the relevance of the attached Declaration to the Proposed Standard in further detail in separate filings in the above-referenced proceedings.

Please do not hesitate to contact the undersigned if you have any questions or concerns about this submission.

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[1] *See* Letter from A. Lipman et al., Counsel for Alpheus Communications, L.P. et al. to Marlene H. Dortch, Secretary, FCC, *In re Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C. § 160(c) in Rhode Island*, WC Dkt. No. 08-24; *In re Petition of the Verizon Telephone Companies for Forbearance Pursuant to 47 U.S.C. § 160(c) in Cox's Service Territory in the Virginia Beach Metropolitan Statistical Area*, WC Dkt. No. 08-49 (filed Mar. 26, 2009).

Respectfully submitted,

<u>/s/ Andrew D. Lipman</u>
Andrew D. Lipman
Russell M. Blau
Joshua M. Bobeck
Philip J. Macres
BINGHAM MCCUTCHEN LLP
2020 K Street, NW
Washington, DC 20006
202-373-6000

Counsel for TDS Metrocom, LLC and PAETEC Holding Corp.

<u>/s/ Thomas Jones</u>
Thomas Jones
Jonathan Lechter
Nirali Patel
WILLKIE FARR & GALLAGHER LLP
1875 K Street, NW
Washington, DC 20006
202-303-1000

Counsel for Cbeyond, Inc., One Communications Corp., and tw telecom inc.

cc: Acting Chairman Michael Copps
Commissioner Jonathan Adelstein
Commissioner Robert McDowell
Nick Alexander
Scott Deutchman
Jennifer Schneider
Julie Veach
Marcus Maher
Tim Stelzig

ATTACHMENT:

DECLARATION OF STANLEY M. BESEN

DECLARATION OF DR. STANLEY M. BESEN

Qualifications

My name is Stanley M. Besen. I am a Senior Consultant at CRA International, Washington, D.C. I previously served as a Brookings Economic Policy Fellow, Office of Telecommunications Policy, Executive Office of the President; Co-director, Network Inquiry Special Staff, Federal Communications Commission; Coeditor, *RAND Journal of Economics*; and a Senior Economist at the RAND Corporation. I currently serve as a member of the Editorial Board of *Economics of Innovation and New Technology*. I have taught at Rice University, where I was the Allyn M. and Gladys R. Cline Professor of Economics and Finance; at Columbia University, where I was the Visiting Henley Professor of Law and Business; and at the Georgetown University Law Center, where I was Visiting Professor of Law and Economics. I have published widely on telecommunications economics and policy, intellectual property, and the economics of standards, and have consulted to many companies in the telecommunications and information industries. I hold a Ph.D. in Economics from Yale University. My curriculum vitae is attached to this report as Appendix A.

Assignment and Conclusions

I have been asked by Cbeyond, Inc., TDS Metrocom, LLC, One Communications Corp., tw telecom inc., and PAETEC Communications, Inc. to describe lessons from the theoretical and empirical economics literatures concerning whether one can presume that there will be competitive pricing when there are only two substantial competitors in a market.[1] As described below, the answer is that one cannot.

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[1] I understand that these firms have filed a response to *Petition of Verizon New England for Forbearance Pursuant to 47 U.S.C.* § *160 in Rhode Island*, WC Dkt. No. 08-24 (filed Feb. 14, 2008).

First, although it is possible in theory that duopoly will lead to fully competitive pricing, so that the entry of a third firm, or additional firms, will not lead to a reduction in prices, this is an extreme and special case. Indeed, this prediction is known as the "Bertrand paradox," correctly suggesting that industrial organization economists view it as highly unlikely to occur in most cases. By contrast, a wide variety of theoretical models recognize, and even predict, that duopoly more typically leads to higher prices than would prevail in a market with a larger number of firms and that the entry of additional firms would result in lower prices. Salinger states the point succinctly: "In virtually any oligopoly model, a merger of two firms [such as one that reduces the number of competitors from three to two] makes the market less competitive."[2]

Second, a substantial body of empirical work in, and across, varying industries confirms that high concentration often leads to higher prices and markups. Although these studies are not definitive, and some studies find little or no relationship between concentration and prices,[3] the preponderance of the evidence is that markets with a small number of firms, or markets in which a few firms have very large market shares, tend to have higher prices than where concentration is lower. A number of these studies identify critical levels of concentration above which prices tend to increase or suggest that entry

[2] M. Salinger, "The Concentration-Margins Relationship Reconsidered," *Brookings Papers on Economic Activity, Microeconomics*, 1990, p. 319. J.T. Scott, "The Price-Concentration Hypothesis and Horizontal Merger Policy," March 24, 2006, p.6, makes a similar point when he notes that "many different theoretical models – both game theoretic models with their mathematical formality and older descriptions of mutual dependence recognized among concentrated sellers – generate the price-concentration hypothesis."

[3] See, e.g., P.S. Clyde and J.D. Reitzes, *The Effectiveness of Collusion Under Antitrust Immunity, The Case of Liner Shipping Conferences*, Bureau of Economics Staff Report, Federal Trade Commission, December 1995 (increases in market concentration are associated with statistically significant, but economically small, increases in freight rates); and O. Ashenfelter and D. Hosken, "The Effect of Mergers on Consumer Prices: Evidence from Five Selected Case Studies," CEPS Working Paper No. 160, February 2008 (estimated price increases might be considered "relatively modest"). At some level, the Ashenfelter-Hosken result is not surprising, however, since the mergers that they analyzed had previously been approved by the antitrust agencies although, of course, that is no guarantee that a merger will not result in an increase in prices.

leads to lower prices when the number of firms in the market is small. In particular, a common finding is that the presence of three or more significant competitors tends to result in lower prices than those that prevail in duopoly.

None of this shows that duopolies never price, or perform, in a fully competitive manner. As a result, antitrust policy goes beyond the *presumption* that high concentration leads to higher prices and investigates specific markets in detail. At the same time, however, economic analysis provides no support for the presumption that duopoly leads to fully competitive outcomes, so that the presence of additional competitors does not result in lower prices. Indeed, the opposite is the case.

Theory

Although there is a theory under which duopolists will charge the same prices as those that would be charged by perfectly competitive firms, one cannot presume that the conditions under which this "Bertrand paradox"[4] will result are present in any real world setting. In the model that leads to this result, two firms can produce at c, where c is the constant unit (marginal and average) cost. They set prices simultaneously; if their prices differ, the lower-priced firm serves all customers while if they set equal prices, each gets half the market. In this model, an equilibrium is for each firm to set its price equal to c. This is also the fully competitive outcome. However, more realistic models that include, for example, product differentiation and pricing dynamics, strongly suggest that duopolies are likely to be able to maintain prices above cost and, therefore, above fully competitive levels.

[4] See J. Tirole, *The Theory of Industrial Organization*, MIT Press, 1988, pp. 209-211 for a discussion of the paradox and pp. 211-212 for a discussion of various ways to resolve it. Tirole concludes (p. 212) that "oligopoly pricing will lead to an outcome intermediate between the Bertrand one and the outcome of the other polar case (the monopoly situation)."

Suppose for example that firm 1 can command a pricing premium among a subset of buyers. This might be the result of "simple" product differentiation, as in many modern models of competition in consumer goods, or it might be of a more subtle kind. For example, some buyers in an intermediate-goods market may be reluctant to rely on firm 2 for their inputs because their downstream business plans threaten firm 2's own legacy downstream business, whereas this issue is less severe (for them) if they purchase from firm 1. In either case, even if firm 2 were to set its price equal to c, firm 1 would not find it profitable simply to do likewise because it would retain some customers even at a higher price. In response, firm 2 could be expected to increase its price. Equilibrium conduct might be complex, even unstable, but, in these situations, both firms typically will end up setting prices above c.

When firms respond to one another's price changes, as is normal in oligopolistic or moderately competitive markets, each firm has an additional incentive to raise its price. In a duopoly market, for example, a firm that raises its prices may reasonably expect that its rival will do so as well. Similarly, a duopolist may be reluctant to reduce its price from a supra-competitive level even if it could capture the entire market at a point in time by doing so if it recognizes that its rival is likely to respond by lowering its prices in the future. In short, merely a recognition that firms will respond to the prices that are being charged by their rivals—even with no suggestion that the firms are colluding —may be sufficient to sustain prices above competitive levels. In addition, of course, more familiar models that fit more naturally into a framework of tacit, or explicit, collusion also indicate that small numbers of significant players may be able to achieve the same result.

The clear implication of this theoretical literature is that entry of a third competitor, or competitors beyond that, will generally lead to lower prices. The empirical economic literature, discussed next, attempts to identify the magnitude of these effects.

Empirical Evidence

Economists have examined three types of evidence in order to quantify the effects of the entry of additional firms on the prices charged by firms in concentrated industries. First, they have compared price-cost margins in different industries with different levels of concentration. Second, they have analyzed how prices in different geographic markets in the same industry vary with the level of concentration in those markets. Finally, they have examined how prices change, or are expected to change, as a result of a merger that significantly reduces the number of competing firms.

The econometric literature on inter-industry comparisons of profits and price-cost margins, on the one hand, and market concentration, on the other, generally shows that higher margins are associated with higher levels of concentration. Although this literature is relatively old, and is subject to a number of criticisms, it is important not to downplay its importance. First, while the literature is out of fashion, this is not because it has been shown to be mistaken. My position on the value of inter-industry studies is close to that of Schmalensee. He observes that these studies "rarely if ever yield consistent estimates of structural parameters, but they can produce useful stylized facts to guide theory construction and analysis of particular industries…..Inter-industry research can complement industry studies by describing robust relations that hold across large samples of markets."[5]

[5] R. Schmalensee, "Inter-Industry Studies of Structure and Performance," *Handbook of Industrial Organization*, Vol. II, R. Schmalensee and R.D. Willig (Editors), Amsterdam: North-Holland, 1989, p. 952.

Second, some of the most compelling criticisms of the literature consist of econometric issues[6] that could well explain “false negatives”— that is, explain why some studies could well have exhibited relatively low explanatory power,[7] unstable results,[8] and small estimated coefficients[9]— even if, in fact, there is a strong relationship between concentration and price. That is, these factors can just as easily lead to a conclusion that there is no link between concentration and prices when one exists as to a conclusion that there is a link when one does not exist.

Criticisms that suggest “false positives”—that is, explain why some studies would find such strong relationships even if no such relationship truly exists—are less in evidence. Moreover, the results of these older studies are generally consistent with those of newer studies that compare prices (e.g., in different geographic markets or over time) within an industry rather than compare price-cost margins across industries.[10]

Schmalensee summarizes the results of this newer literature with the following “Stylized Fact”: “In cross-section comparisons involving markets in the same industry,

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[6] Among the criticisms of such studies are: (1) it may be difficult to obtain the quality-adjusted prices that are needed to assess the relationship between prices and concentration across markets; (2) markets with small numbers of firms may also be high cost markets, so that at least some of the higher prices in those markets may inappropriately be attributed to high concentration if such differences are not accounted for; (3) market structure may be affected by prices, so that statistical estimates may be subject to simultaneous equations bias; and (4) the market may be incorrectly defined, so that the numbers and identities of competing firms are mis-specified.

[7] The explanatory power of a model is measured by the proportion of the variation in a (dependent) variable, in this case price, that is “explained” by, or associated with, the variations in other (independent or explanatory) variables, one of which in this case is a measure of market concentration.

[8] Results are unstable when they are sensitive to changes in, for example, the identities of the explanatory variables that are included in the model, the way in which the variables are defined, the mathematical form of the assumed relationship between the dependent and explanatory variables, and/or the time period covered by the analysis.

[9] A coefficient measures the estimated effect of a change in the dependent variable that results from a one unit change in an independent variable holding constant the effects of the other independent variables. A coefficient can be small in a statistical sense, if the estimated effect of a change in an independent variable cannot be distinguished from no effect, or it can be small in an economic sense, if the estimated effect is not quantitatively important.

[10] For a discussion of some of these issues, including an explanation of why one popular criticism is somewhat misplaced, see M. Salinger, op. cit.

seller concentration is positively related to the level of prices."[11] Similarly, Bresnahan observes that "these studies confirm the existence of a relationship between price and concentration, which is at least suggestive of market power increasing with concentration."[12] Pautler reports that "Several studies of price/concentration relationships indicate that prices are higher where concentration is higher or the number of sellers is lower."[13] More recently, Coates and Hubbard report that: "Empirical studies of auction markets and various industries, such as airlines, railroads, books, and pharmaceuticals, show prices declining as the number of bidders or rivals increases and as concentration of sales in a few firms declines."[14] Finally, Sutton states: "that a fall in concentration will lead to a fall in prices and price-cost margins is well supported both theoretically and empirically."[15]

Other studies seek to go beyond this general conclusion in two ways. Some attempt to identify a "critical" level of concentration above which prices tend to rise, on the plausible hypothesis, consistent with leading theoretical models, that there may be little difference in prices between markets that have different but fairly low levels of concentration. Others analyze whether, and how, prices vary with the distribution of market shares among firms even with the same level of measured market concentration.

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[11] Id., p. 988.
[12] T.F. Bresnahan, "Empirical Studies of Industries with Market Power," *Handbook of Industrial Organization*, Vol. II, op. cit., p. 1043. Bresnahan identifies studies in industries such as banking, food retailing, gasoline supply, airlines, and cement.
[13] See P.A. Pautler, "Evidence on Mergers and Acquisitions," *The Antitrust Bulletin*, 2003, pp. 188-89. Pautler identifies studies in industries such as banking, airlines, food retailing, gasoline retailing, ocean shipping, hospitals, and natural gas transportation.
[14] J.C. Coates and R.G. Hubbard, Competition in the Mutual Fund Industry: Evidence and Implications for Policy, John M. Olin Center for Law, Economics, and Business, Harvard University, Discussion Paper No. 592, August 2007, p.11, http://www.law.harvard.edu/programs/olin_center/papers/pdf/Coates_592.pdf.
[15] J. Sutton, "Market Structure: Theory and Evidence," in *Handbook of Industrial Organization*, Vol. III, M. Armstrong and R.H. Porter (editors), North-Holland, 2007, p. 2307. Sutton describes this claim as "uncontroversial".

Finally, there have been a number of studies of the price effects of horizontal mergers that reduced an already small number of competing firms.

An early study by Kwoka found that "Large market shares for the two leading firms seem most decisive for industry price-cost margins, with a depressing effect from a sufficiently large third share."[16] His results suggest that duopolists are likely to have high price-cost margins, and that the presence of a third substantial firm would reduce these margins, although a third firm with only a small market share might have little effect.[17]

Bresnahan and Reiss examined the relationship between prices and the number of firms in geographically isolated markets in the Western United States.[18] Studying markets for tires, for example, they found that "markets with three or more dealers have lower prices than monopolists or duopolists."[19] Bresnahan and Reiss obtain similar results for the entry of firms beyond two in markets for doctors, dentists, druggists, and plumbers.

Thus, these studies suggest that, at least in some industries, the presence of a third substantial competitor results in a significant reduction in prices. This implies that duopoly does not bring prices all the way to fully competitive levels, because otherwise the entry of the third foresighted competitor would have no effect.[20] Of course, the presence of additional firms might lead to *even lower* prices. Indeed, as noted, a number of studies suggest that, in some markets, it does so.

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[16] See J.E. Kwoka, "The Effect of Market Share Distribution on Industry Performance," *The Review of Economics and Statistics*, 1979, p. 108. Kwoka finds that the shares of firms beyond the largest three do not have a significant effect on price-cost margins.

[17] Kwoka estimates that the presence of a third competitor affects prices once its share is greater than or equal to 16 percent (Id., p. 107), which appears to be his definition of "large".

[18] See T.F. Bresnahan and P.C. Reiss, "Entry and Competition in Concentrated Markets," *Journal of Political Economy*, 1991.

[19] Id. p. 1006.

[20] By foresighted, I mean that the third firm would not enter if it recognized that it would experience losses if it were to do so.

Moreover, even if the presence of a third firm does not have a significant effect on prices in a particular industry, that need not imply that duopoly (two firms) achieves a fully competitive outcome. It could still be the case that the presence of a fourth, fifth, or more firms would lead to lower prices. Thus, for example, Bresnahan and Reiss found that tire prices in markets with three to five dealers "are higher than unconcentrated market prices," leading them to conclude that "it appears that there are other intermediate ranges of concentration in which entry increases competition and lowers prices."[21]

Somewhat similarly, although Kwoka's analysis suggested that the addition of firms beyond the three largest has little or no effect on prices, this conclusion has been subject to some criticism on the grounds that his model was biased against finding an effect for the entry of firms beyond the third. For example, Mueller and Greer re-analyzed Kwoka's data, and claim that "the fourth firm as well as groups of firms below the top two possess characteristics similar to that of the third firm."[22] That is, they find that firms beyond the third exert an additional downward effect on prices, i.e., that three substantial firms are still not enough for fully competitive pricing.

Parker and Roller compare U.S. cellular prices between the monopoly (ILEC only) and duopoly periods.[23] They find that prices fell with the entry of the second firm but not to competitive levels. They conclude: "a duopolistic industry structure is…not competitive and prices are not equal to marginal costs. On the other hand, the hypothesis that the duopoly's pricing behavior is consistent with cartel is also rejected....The

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[21] Id.
[22] See W.F. Mueller and D.F. Greer, "The Effect of Market Share Distribution on Industry Performance: Re-Examined," *The Review of Economics and Statistics*, 1984, p. 357. For a response see J.E. Kwoka, "The Effect of Market Share Distribution on Industry Performance: Reply," *The Review of Economics and Statistics*, 1984.
[23] P.M. Parker and L-H. Roller, "Collusive Conduct in Duopolies: Multimarket Contact and Cross-ownership in the Mobile Telephone Industry," *RAND Journal of Economics*, 1997.

hypothesis consistent with noncooperative behavior...is also rejected….We therefore conclude that the industry on average is more collusive than noncooperative duopoly after the second firm enters the market."[24]

Examining a somewhat later period, Hausman reports that "price fell significantly in 1995-96 when the new entry of PCS [Personal Communications Service] occurred. Thus, as expected, new entry along with deregulation of prices by the FCC led to a faster decrease in prices than had previously occurred."[25] In an analysis of an even later period, Hausman reports that "the effect of …competition on wireless rates in the U.S. has been significant. Throughout the 1984-1995 period, real, inflation-adjusted cellular rates had fallen at a rate of 4 percent to 5 percent per year. Between 1995 and 1999, however, real cellular rates fell at a rate of 17 percent per year as PCS service providers offered service at prices per minute in bucket plans that were more than 50 percent lower than existing cellular rates."[26] Notably, the authorization of PCS service meant that most U.S. households could receive service from at least three mobile service providers, where previously they could receive service from at most two.[27]

Penard provides a striking example of how the entry of a third mobile telephone firm into a market previously served by a duopoly can affect prices.[28] He compares the prices

[24] Id., p. 317.
[25] J. Hausman, "Mobile Telephone," in M.E. Cave, S.K. Majumdar, and I. Vogelsang (editors), *Handbook of Telecommunications Economics*, Volume 1, Elsevier, 2002, p. 579.
[26] Id., p. 580, p. 582.
[27] Federal Communications Commission, *In the Matter of Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Radio Services*, Third Report, 13 FCC Rcd. 19746, Adopted: May 14, 1998; Released: June 11, 1998 noted (p. 3): "There are at least three mobile telephone providers in each of the 50 largest Basic Trading Areas ("BTAs") and 97 of the 100 largest BTAs. Currently, three or more mobile telephone operators are providing service in BTAs containing approximately 219 million people."
[28] T. Penard, "Competition and Strategy on the Mobile Telephony Market: a Look at the GSM Business Model in France," *Communications and Strategies*, 2002.

charged by, the entrant, Bouygues Telecom for mobile telephone service in France to the prices offered by the incumbents, France Telecom and SFR prior to the time at which Bouygues was authorized to provide service. He reports that "The cost of the flat rates marketed by Bouygues starting in 1996 was well below that of the existing offers: close to 70% less than the prices charged by the existing operators for an equivalent call volume…[29] Here, the entry of a third competitor clearly had a dramatic effect on prices.

Indeed, the FCC itself has recognized that duopolies cannot be expected to price competitively and that the entry of additional firms could be expected to lead to lower prices. For example, in the Commission's First Report on competition in mobile telephone service, it noted:

> The duopoly nature of cellular service made it less than fully competitive…. Therefore, in the early 1990s, the Commission allocated 143 MegaHertz ("MHz") of spectrum, almost three times the spectrum allocation for cellular service, to create Personal Communications Services ("PCS")…. Already, the approach of broadband PCS appears to be influencing incumbent wireless providers to lower prices and increase features.[30]

In food retailing, Lamm finds that "it is clear that growth in the 3 largest firms' shares have a significant positive effect on prices with growth in the second largest firm's share dominating. In contrast, an increase in the market share of the *fourth largest firm* causes a reduction in food prices."[31] Thus, whereas Kwoka finds that it takes a third significant firm to lower prices, Lamm finds that moderation in prices requires the presence of a fourth significant firm.

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[29] Id., p. 65.
[30] Federal Communications Commission, *In the Matter of Implementation of Section 6002(b) of the Omnibus Budget Reconciliation Act of 1993, Annual Report and Analysis of Competitive Market Conditions with Respect to Commercial Mobile Radio Services*, First Report, 10 FCC Rcd. 8844, Adopted: July 28, 1995; Released: August 18, 1995, para. 4.
[31] R.M. Lamm, "Prices and Concentration in the Food Retailing Industry," *Journal of Industrial Economics*, 1981, p. 75, emphasis added.

Studying auction markets, Brannman, Klein, and Weiss analyzed the effect of an increase in the number of bidders on tax exempt underwriting fees, bonus bids for offshore oil leases, and bids for National Forest Service timber sales.[32] They estimate how winning bids with 1, 2, …., 11 bidders compare versus winning bids when there are 12 or more bidders. They find "a systematic tendency for the winning bid to decline as the number of bidders increases" (underwriting fees),[33] "leases with greater competition [larger numbers of bidders] are won with higher bids for tracts of equal quality" (offshore oil leases),[34] and that "winning bids increase with the number of bidders" (timber sales).[35] Interestingly, an increase in the number of bidders seems to affect prices whether the increase is, say, from 3 to 4, or from, say, 8 to 9, although the magnitude of the effect is smaller the larger is the number of bidders.[36]

Finally, Geithman, Marvel, and Weiss attempted to identify a "critical" level of concentration at which prices begin to increase, in municipal bond underwriting, gasoline retailing, and supermarkets.[37] In gasoline retailing they find a critical two-firm concentration ratio of about 35 and a critical four-firm ratio of about 50.[38] They find a four firm concentration ratio (assuming equal sized firms) at about 50 for general obligation bond underwriting and about 80 for revenue bond underwriting.[39] At least for

[32] L. Brannman, J.D. Klein, and L.W. Weiss, "The Price Effects of Increased Competition in Auction Markets," *Review of Economics and Statistics*, 1987. Note that increased competition is reflected in *lower* bids for bond underwriting fees and *higher* bids for offshore oil leases and timber sales.
[33] Id., p. 27.
[34] Id., p. 28.
[35] Id.
[36] Id., Table 1, p. 27.
[37] F.E. Geithman, H.P. Marvel, and L.W. Weiss, "Concentration, Price, and Critical Concentration Ratios," *Review of Economics and Statistics*, 1981.
[38] Id., p. 349, p. 352. The two-firm concentration ratio is the proportion of total industry output that is produced by the two largest firms. The four-firm concentration ratio is the proportion produced by the four largest firms.
[39] Id., p. 348. For supermarkets, they estimated a critical four firm concentration of about 40, but the results did not appear to be robust.

these industries, their estimates suggest that duopolies would result in prices above competitive levels.

Mergers provide an additional source of information about the effect of concentration and the number of substantial competitors on prices. In some cases this evidence takes the form of analyzing the results of *consummated* mergers; in other cases it consists of evidence developed to aid antitrust agencies and courts in evaluating a *proposed* merger. The latter is by definition counterfactual and is therefore often indirect, but sometimes direct evidence is also available.

For instance, relatively direct evidence was developed in the proposed merger between Staples and Office Depot. The Federal Trade Commission opposed the proposed merger, based in part on an analysis of the prices charged by "Superstores", the two merging parties and Office Max, when only one of these firms was present in a market, when only two were present, and when all three were present.[40] It found, for example, that prices were more than 11 percent higher in markets where only Staples was present than in markets with both Staples and Office Depot stores. Similarly, the FTC found that prices were almost 5 percent higher in markets where only Staples and Office Max were present than in markets with all three "Superstores."[41] This result suggests that the presence of a third major firm had a moderating effect on prices even though (as Staples and Office Depot argued) other retail outlets for stationery were present in all of

[40] S. Dalkir and F.R. Warren-Boulton, "Prices, Market Definition, and the Effects of Merger: Staples-Office-Depot (1997)", in *The Antitrust Revolution: Economics, Competition and Policy* (J.E. Kwoka and L.J. White, eds.), Oxford University Press, 4th edition, p. 62, summarizes these results. The FTC also provided an econometric analysis in support of this conclusion. See O. Ashenfelter, D. Ashmore, J.B. Baker, S. Gleason, and D.S. Hosken, "Econometric Methods in *Staples*," for a detailed discussion of this analysis.

[41] Prices were 2.5% higher in markets in which Office Depot and Office Max were present than were all three "superstores" were present.

these markets, so that, from an economic point of view, the "duopoly" markets included what one might reasonably consider to be (at least) additional fringe firms.

In addition to showing a difference between prices in markets with two and three major firms present, the Staples evidence suggests that, without further analysis, one should not be too quick to count fringe or differentiated players as being fully equivalent to major direct competitors. As the *Staples* Court concluded:

> The evidence shows that the defendants change their price zones when faced with entry of another superstore, but do not do so for other retailers. … There are numerous … examples of zones being changed and prices falling as a result of superstore entry. There is no evidence that zones change and prices fall when another non-superstore retailer enters a geographic market.[42]

Retrospective analysis of consummated mergers has been an important recent source of information on the effects of concentration and the number of (significant) firms.[43] For example, analyzing the merger of Northwest Airlines and Republic Airlines, Borenstein found that "only…where both of the merging carriers competed along with one other airline…was there a significant average price increase" shortly after the merger occurred.[44] In his interpretation, the fact that prices increased on routes where Northwest and Republic competed with one other carrier before the merger, leaving a duopoly thereafter, supports the conclusion "that airlines find it much more difficult to tacitly collude in markets with three carriers than in markets with two carriers."[45]

Studying the more or less contemporaneous merger of Trans World Airlines and Ozark Airlines, Borenstein concludes that the merger did not increase prices but that on

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[42] *Federal Trade Commission v. Staples, Inc.*, 970 F. Supp. 1066, 1078 (D.D.C. 1997).
[43] See, e.g., P.A. Pautler, "Evidence on Mergers and Acquisitions," op. cit., pp. 145-184, for a survey of these studies.
[44] S. Borenstein, "Airline Mergers, Airport Dominance, and Market Power," *American Economic Review*, 1990, p. 402.
[45] Id.

routes where the merging parties (pre-merger) operated as a duopoly, "prices were consistently and substantially above industry average," consistent with the presumption that the presence of a third competitor would have resulted in lower prices.[46]

Policy Reflecting Theory and Evidence

The *Horizontal Merger Guidelines* of the U.S. Department of Justice and the Federal Trade Commission characterize markets with an HHI above 1800 as "highly concentrated."[47] The Guidelines go on to state that "Mergers producing an increase in the HHI of more than 50 points in highly concentrated markets post-merger potentially raise significant competitive concerns…."[48]

The HHI threshold for "highly concentrated" is inevitably met and exceeded in markets with five or fewer firms. For instance, an industry with three equal size firms would have an HHI of 3333, well above the threshold of 1800. With only two firms, the smallest possible HHI would be 5000, which would occur if the firms were of equal size. While the Guidelines fully recognize that high concentration (and, for mergers, large increases in concentration) is not proof of weak (or weakened) competition, their fundamental analytical structure depends on such levels of concentration raising concerns that must be carefully evaluated and rebutted before a highly concentrating merger is allowed to proceed. Translating from the merger context to the question at hand, this indicates that there is a presumption, though not a final conclusion, that a

[46] Id., pp. 401-402. He does find, however, that "these prices fell relative to the industry average around the time of the merger, significantly so for the routes that had been served by only one of the merging airlines. (Id., p. 402).

[47] Horizontal Merger Guidelines, U.S. Department of Justice and the Federal Trade Commission, Issued: April 2, 1992, Revised: April 8, 1997, p. 16. The HHI is the sum of the squared market shares of the firms in an industry. The HHI thus takes the value 10,000 (100^2) if there is a single firm, 5,000 (50^2+50^2) if there are two equal size firms, 3750 ($50^2+25^2+25^2$) if one firm has a 50 percent market share and two other firms each have a 25 percent market share, etc.

[48] Id.

market with only two firms will have higher prices than a market with three or more competitors.

Illustrating this, a former Chairman of the Federal Trade Commission has noted, "2-to-1 or 3-to-2 mergers in well-defined markets protected from entry are likely to pass the anticompetitive theory test simply because of the very low number of competitors."[49] Similarly, commenting on possible perceptions that the Department of Justice would not oppose mergers that left more than two firms in a market, a Deputy Assistant Attorney General in the Antitrust Division of the U.S. Department of Justice noted: "…some [have] speculate[d] that we have lost confidence in our ability to predict when a merger, other than a 3-to-2 merger, will increase the likelihood of coordination or to win such cases in court. Standing here today, I want to disabuse you all of that view."[50] He apparently saw no need to respond to speculation about how the Department would respond to 3-to-2 mergers. Very recently, a former Assistant Attorney General in the Antitrust Division is quoted as saying that "Any 'three to two merger' to my mind would require a significant investigation."[51]

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[49] Timothy J. Muris, Understanding Mergers: Strategy and Planning, Implementation, and Outcomes, December 9, 2002, http://www.ftc.gov/speeches/muris/mergers021209.shtm. The Office of Fair Trading in the United Kingdom, Revision to *Mergers – substantive assessment guidance*, Exception to the duty to refer: markets of insufficient importance, OFT516b, November 2007, reaches a similar conclusion: "…where the OFT considers each merging party to be the *only* significant competitor to the other (a '2 to 1' merger) or one of only two (a '3 to 2' merger), the merger would typically lead to large price increases and/or quality or innovation cutbacks, which will endure into the medium term and potentially beyond…." (emphasis in original). Although the language is from a document that considers "markets of insufficient importance," the point is clearly more general. http://www.oft.gov.uk/shared_oft/business_leaflets/enterprise_act/oft516b.pdfand/or.

[50] William J. Kolasky, Coordinated Effects in Merger Review: From Dead Frenchman to Beautiful Minds and Mavericks, April 24, 2002, http://www.usdoj.gov/atr/public/speeches/11050.htm.

[51] See Thomas Barnett, Ex-Antitrust Chief: Yahoo!/Microsoft Deal Hard Call**,** Yahoo! Press Room, February 6, 2009, http://yhoo.client.shareholder.com/PRESS/inthenews.cfm?ArchiveWeek=20090206. As noted above, modern antitrust authorities would not always oppose a highly concentrating merger. Among ameliorating factors might be product heterogeneity, difficulty in detecting and punishing deviations from coordinated behavior, the presence of a maverick firm, the ability of rival firms to expand output or reposition their products, the ease of entry, and efficiencies that are likely to result from the merger.

Conclusion

Virtually all theoretical models of oligopoly predict that highly concentrated industries will not exhibit competitive behavior. Moreover, a substantial body of empirical evidence indicates that concentration often leads to higher prices even in markets with low entry barriers. Together, these are sufficient to justify the presumption that duopolies will *not* price competitively. Without further detailed analysis, therefore, the FCC cannot conclude that the presence of only two firms is sufficient to achieve a competitive outcome and they can reasonably presume that the entry of a third firm is likely to result in prices that are closer to competitive levels.

Moreover, in some cases, the combination of two weak competitors could actually increase the competition faced by a dominant firm. My point rather is that it would be a startling departure from consensus policy to *presume* that a three to two merger would not result in higher prices.

I hereby declare under penalty of perjury that the foregoing is true and accurate to the best of my knowledge and belief.

Executed on April 22, 2009

Stanley M. Besen

Stanley M. Besen

APPENDIX A

STANLEY M. BESEN

EDUCATION

City College of New York
B.B.A., Economics (1958)
Yale University
M.A., Economics (1960)
Ph.D., Economics (1964)

PROFESSIONAL EXPERIENCE

2008- Senior Consultant, CRA International, Inc.

1992-2008 - Vice-President, CRA International, Inc.

1980-1992 - Senior Economist, The Rand Corporation, Washington, D.C.

1990-1991 - Visiting Professor of Law and Economics, Georgetown University Law Center

1988-1989 - Visiting Henley Professor of Law and Business, Columbia University

1985-1988 - Coeditor, Rand Journal of Economics

1978-1980 - Co-Director, Network Inquiry Special Staff, Federal Communications Commission

1971-1972 - Brookings Economic Policy Fellow, Office of Telecommunications Policy, Executive Office of the President

1965-1980 - Assistant Professor, Associate Professor, Professor of Economics, Allyn R. and Gladys M. Cline Professor of Economics and Finance, Rice University

1963-1965 - Economist, Institute for Defense Analyses

1962-1963 - Acting Assistant Professor of Economics, University of California, Santa Barbara

CONSULTANCIES

The Rand Corporation, 1972-1978

Office of Telecommunications Policy, Executive Office of the President, 1972-1977

Department of Defense, 1967

PROFESSIONAL ACTIVITIES/HONORS

Member, National Research Council Board on Earth Sciences and Resources, Division on Earth and Life Studies, Committee on Licensing Geographic Data and Services, 2002-2004

Member, The National Academies Computer Science and Telecommunications Board Committee on Internet Searching and the Domain Name System, 2001-2004

Member, Editorial Board, Economics of Innovation and New Technology, 1989-present

Member, Editorial Board, Information Economics and Policy, 1992-2004

Member, U.S. National Committee on Data for Science and Technology (CODATA), National Academy of Sciences/National Research Council, 1993-1996

Member, Office of Technology Assessment Advisory Panel on Communications Systems for an Information Age, 1986-1988

Member, Regional Telecommunications Planning Advisory Committee, City of Cincinnati, 1985

Member, Office of Technology Assessment Advisory Panel on Intellectual Property Rights in an Age of Electronics and Information, 1984-1985

Expert, World Intellectual Property Organization/UNESCO Meeting on Unauthorized Private Copying of Recordings, Broadcasts and Printed Matter, 1984

Who's Who in America, 1982-1983, 1984-1985, 1986-1987, 1988-1989, 1990-1991, 1992-1993, 1994, 1995, 1996, 1997, 1998, 1999, 2000, 2001, 2002, 2003, 2004, 2005, 2006, 2007, 2008

Member, Editorial Board, Southern Economic Journal, 1979-1981

Member, Task Force on National Telecommunications Policy Making, Aspen Institute Program on Communications and Society, 1977

Brookings Economic Policy Fellow, 1971-1972

Member, Technical Advisory Committee on Business Development, Model City Program, City of Houston, 1969-1971

Wilson University Fellow, 1959-1961

Overbrook Fellow, 1958-1959

Beta Gamma Sigma, 1958

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Witness, Subcommittee on Telecommunications, Consumer Protection, and Finance, Committee on Energy and Commerce, U.S. House of Representatives, 1981. Prepared statement and testimony appear in **Status of Competition and Deregulation in the Telecommunications Industry**, 97th Congress, 1st Session.

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ATTACHMENT D

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of Petitions of Qwest Corporation for Forbearance Pursuant to 47 U.S.C. § 160(c) in the Phoenix, Arizona Metropolitan Statistical Area	)))))))	WC Docket No. 09-135

DECLARATION OF DOUGLAS K. DENNEY
ON BEHALF OF INTEGRA TELECOM, INC.

1. I am Director of Costs and Policy for Integra Telecom, Inc. ("Integra"). In this role, my responsibilities include negotiating interconnection agreements, monitoring, and reviewing and analyzing the wholesale costs that Integra and its affiliates pay to carriers such as Qwest. I received a B.S. degree in Business Management from Phillips University in 1988. I spent three years doing graduate work at the University of Arizona in Economics, and then I transferred to Oregon State University, where I completed all of the requirements for a Ph.D. except my dissertation. My field of study was Industrial Organization, and I focused on cost models and the measurement of market power. I taught a variety of economics courses at the University of Arizona and Oregon State University. I was hired by AT&T in December 1996 and spent most of my time with AT&T analyzing cost models. In December 2004, I was hired by Eschelon Telecom, Inc., which was subsequently purchased by Integra, where I am presently employed. I have participated in more than 40 proceedings in the 14-state Qwest region, including most unbundled network element ("UNE") cost proceedings that set the current UNE rates in the Qwest territory. I have also testified about issues relating to wholesale service quality (including Performance Indicator Definitions and Performance Assurance Plans) and the

wholesale cost of local service (including universal service funding, UNE pricing, geographic deaveraging, and competitive local exchange carrier access rates), interconnection agreement arbitrations and wire center non-impairment proceedings.

2. Integra is the fourth largest competitive local exchange carrier in the United States. It provides voice, data, and Internet communications to thousands of business and carrier customers in 11 Western states, including Arizona. Integra owns and operates a 2,200-route mile metropolitan area network and a 4,700-mile long haul network. Because of the prohibitive cost of self-provisioning loop and interoffice transport facilities, the company typically leases 2-wire, DS1, and DS3 loops, DS1 point-to-point enhanced extended loops ("EELs"), DS1 multiplexed EELs, and in many cases, DS3 interoffice transport facilities, from Qwest.

3. The purpose of this declaration is to demonstrate the likely financial impact of the elimination of UNEs on Integra's business in the Phoenix Metropolitan Statistical Area ("MSA"). For this purpose, Integra recently conducted separate studies of the costs it incurs to provide services via DS1 point-to-point EELs, 2-wire loops, and stand-alone DS1 loops in the Phoenix MSA and the changes to its operating margins in the event that Qwest's petition for forbearance from unbundling obligations in the Phoenix MSA was granted.

4. The DS1 point-to-point EELs study is based on the cost-based UNE price for a six-mile EEL in each density zone (which helps determine pricing based on a customer's location within an MSA) in the Phoenix MSA. Given that special access DS1s are the alternative product offered by Qwest when DS1 UNEs are eliminated, the study assumes that the cost of a DS1 EEL (with an assumed mileage of six miles) will increase to the relevant Qwest special access price for this service, which is \$281.39, plus \$5.98 for the Interconnection Tie Pair ("ITP"), for a total monthly special access charge of \$287.37, as established in Qwest Tariff FCC

No. 1. This rate includes the 22 percent discount off of the monthly special access rate that would be available to Integra under Qwest's Regional Commitment Plan ("RCP") if Integra were to purchase the requisite volume of DS1 EELs from Qwest as special access.[1] As summarized in the following table, if Integra were forced to pay the special access price instead of the UNE EEL price, its per-circuit monthly recurring costs would increase by at least 117 percent:[2]

Integra DS1 EEL Cost Increases If Forbearance Is Granted In The Phoenix MSA		
Loop & Transport (6 miles)	**Actual Cost Increase**	**Percentage Cost Increase**
UNE Zone 1	$182.04	168.4%
UNE Zone 2	$172.17	158.6%
UNE Zone 3	$137.50	117.7%

5. In order to calculate the effect of these price increases on Integra's operating margins in the provision of a DS1 retail service, such as an integrated channelized product,[3] using DS1 EEL-based wholesale rates, we allocated to those services a proportionate share of joint and common monthly recurring expenses that Integra incurs, such as charges associated with collocation, interconnection trunking, transit, and SS7 charges. We performed this allocation using the same methodology Integra uses to determine whether its retail prices cover its joint and common costs in a market. In addition, we allocated to Integra's costs the company's sales, general, and administrative ("SG&A") expenses, network backbone costs and

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[1] *See* Qwest Corp. Tariff FCC No. 1 §§ 7.11.4.A.1 (5th revised page 7-347) (effective Aug. 19, 2006), 7.11.4.C.1.a (1st revised page 7-354.1) (effective July 1, 2003), 17.2.11.A.1 (4th revised page 17-91) (effective Aug. 19, 2006), 17.2.11.C.1.a (1st revised page 17-98.1) (effective Aug. 31, 2004), & 21.5.2.D (1st revised Page 21-41) (effective Sep. 19, 2003). The Qwest special access price of $287.37 is comprised of the weighted average (based on Qwest's switched business lines) of the special access zone 1, 2, and 3 tariff prices for a DS1 channel termination, a fixed mileage charge, a total variable mileage charge for six miles, a total ITP cost of $5.98, and a discount of 22 percent under Qwest's RCP, which applies to all components except the ITP. Special access channel termination and transport rates are dependent upon the special access zone designation and whether or not Qwest has special access pricing flexibility in a wire center.

[2] Only 4.6 percent of the lines are in UNE Zone 3 in the Phoenix MSA.

[3] This product is a multi-service T1 that delivers both voice lines and internet access.

Cap Ex. When these costs are accounted for, the total monthly special access cost of a DS1 EEL is **[HIGHLY CONFIDENTIAL BEGIN]** **[HIGHLY CONFIDENTIAL END]**.

6. Using this analysis, Integra's operating cash flow margin across all zones in the Phoenix MSA would be **[HIGHLY CONFIDENTIAL BEGIN]** **[HIGHLY CONFIDENTIAL END]**. Specifically, as demonstrated in the following table, if UNEs were eliminated, Integra's operating cash flow margin for each DS1-EEL-based circuit offered at retail would be **[HIGHLY CONFIDENTIAL BEGIN]**

[HIGHLY CONFIDENTIAL END]

Under these circumstances, Integra would not be able to profitably serve customers in the market for DS1-EEL-based services.

7. It is also important to point out that Qwest might try to increase its special access prices above current levels (as it has in the past). In fact, without the constraining effect of the availability of UNEs, it is entirely possible that Qwest would do so. Moreover, in addition to

[4]This is the average total revenue Integra receives for this product including long distance and CABs billing.

increasing the costs of wholesale inputs, Qwest could decrease its retail prices. Indeed, Qwest has already offered a promotional retail rate of $450.00 for a DS1 service.[5] Qwest may also offer, on an individual case basis ("ICB"), lower retail prices for intrastate tariffed services in order to respond to any competitor's price.[6] Qwest's past practices demonstrate the very real possibility that it would impose a price squeeze on Integra if UNEs were eliminated. A price squeeze would render Integra unable to make a profit.

8. Moreover, these concerns are not limited to DS1-EEL-based services. Integra conducted similar cost studies for 2-wire and DS1 loops. In the 2-wire loop cost study, we assumed that, post-forbearance, Integra would be required to pay at least the "commercial" rate offered by Qwest for 2-wire loops in the Omaha MSA after it received forbearance from unbundling obligations in certain wire centers in Omaha. That price is $15.71 per month per 2-wire loop.[7] As shown in the following table, based on this assumption, if forbearance is granted, the cost of a 2-wire loop in Zone 1 of the Phoenix MSA would increase by 73.6 percent:[8]

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[5] *See* Product Notification from Qwest Corp. to CLECs, Resellers, and ISPs of "2009 Spring ISDN & DSS Promotion" (dated April 3, 2009) (offering promotional pricing of $450 on Advanced Digital Switched Service on three-year contracts from May 26, 2009 to August 21, 2009) (attached hereto as Exhibit A).

[6] *See* Qwest Corp., Large Business Products & Services, Data Solutions, DS-1, www.qwest.com/pcat/large_business/product/1,1016,140_4_2,00.html (last visited Apr. 28, 2010) ("Qwest DS-1 is filed and priced in both the interstate and the intrastate tariffs. . . . In competitive situations, intrastate DS-1 service may be priced on an Individual Case Basis."). Qwest has filed notice of more than 40 ICB contracts involving DS-1 retail service in Arizona in the past year.

[7] *See* Petition for Modification of McLeodUSA Telecommunications Services, Inc., WC Dkt. No. 04-223, Declaration of Don Eben, Exhibit 3, Appendix 4 - Qwest Commercial DS0 Agreement at 69-70 (listing monthly 2-wire DS0 loop rate as $15.71) (filed July 23, 2007).

[8] Note there are no guarantees that Qwest will limit 2-wire loop rate increases to the increases Qwest imposed in Omaha. For example, Qwest's tariff FCC No. 1 § 7.4.4.A (2nd revised page 7-210) (effective July 2, 2002) contains a 2-wire standard voice channel rate of $21.57.

Integra DS0 Loop Cost Increases If Forbearance Is Granted In The Phoenix MSA		
	Actual Cost Increase	Percentage Cost Increase
Zone 1	$6.66	73.6%
Zone 2	$0.87	5.9%
Zone 3	-	-

In the 2-wire loop study, we assumed a basic voice product offering and applied all of the same cost allocations and made the same assumptions as in the DS1 EELs study. As demonstrated in the following table, the 2-wire loop study also revealed that the operating cash flow margin for 2-wire loops would be **[HIGHLY CONFIDENTIAL BEGIN]** **[HIGHLY CONFIDENTIAL END]** if UNE 2-wire loops were unavailable in the Phoenix MSA, indicating that Integra would likely be price squeezed out of the market for 2-wire loop-based services, such as business voice lines:

[HIGHLY CONFIDENTIAL BEGIN]

[HIGHLY CONFIDENTIAL END]

9. Finally, in conducting the study for the integrated channelized product using stand-alone DS1-loops, we again used the same methodology. Accordingly, as shown in the

following table, if forbearance is granted in the Phoenix MSA, the cost of a stand-alone DS1 loop would increase by at least 69 percent:

Integra DS1 Loop Cost Increases If Forbearance Is Granted In The Phoenix MSA		
	Actual Cost Increase	**Percentage Cost Increase**
Zone 1	$75.28	110.3%
Zone 2	$73.87	107.5%
Zone 3	$53.07	69.0%

We concluded that Integra's cash flow margin for the integrated channelized product without the availability of stand-alone DS1 UNE loops would be **[HIGHLY CONFIDENTIAL BEGIN]**

[HIGHLY CONFIDENTIAL END]

Such **[HIGHLY CONFIDENTIAL BEGIN]** **[HIGHLY CONFIDENTIAL END]** margins would make it difficult for Integra to justify continuing to offer DS1 loop-based services.

I declare under penalty of perjury that the foregoing is true and correct to the best of my information and belief.

Douglas Denney

Dated: 4/28/2010

EXHIBIT A

Qwest

April 3, 2009

Doug Denney
Eschelon Telecom of Arizona Inc.
Eschelon Telecom of Colorado Inc.
Eschelon Telecom of Minnesota Inc.
Eschelon Telecom of Oregon Inc.
Eschelon Telecom of Utah Inc.
Eschelon Telecom of Washington Inc.
730 2nd Av S Suite 900
Minneapolis, MN 55402
dkdenney@integratelecom.com

TO:Doug Denney

Announcement Date:	**April 3, 2009**
Effective Date:	**May 26, 2009**
Document Number:	**PROD.04.03.09.F.06233.ISDN_DSS_Spring_Promo**
Notification Category:	**Product Notification**
Target Audience:	**CLECs, Resellers and ISP-GET – 14 State Region**
Subject:	**2009 Spring ISDN & DSS Promotion**

This is to advise you of changes to a Qwest retail service offering. Please be advised that retail offers that are subject to Commission approval may change. Resellers should monitor filings since Qwest will not provide notification of changes.

Tariff/catalog/price list reference:

Malheur – Exchange and Network Services Catalog, Section 16
Minnesota – Exchange and Network Services Price List, Section 16
Montana – Exchange and Network Services Tariff, Section 16
Nebraska – Exchange and Network Services Catalog, Section 16
Oregon – Exchange and Network Services Tariff, Section 16
Oregon – Exchange and Network Services Price List, Section 16
Washington – Exchange and Network Services Catalog, Section 16

State(s): 14 State Region

Product Description: For a limited 88-day period from May 26, 2009, to August 21, 2009, Qwest is offering a special per span, bulk-rated promotional pricing for the following services:

	MONTHLY RATE FOR	
	3 YEAR RATE	**5 YEAR RATE**
• ISDN PRS Voice & Data or UAS option on DS1	$650.00	$550.00

• ISDN PRS Voice & Data or UAS option on DS3 or higher	625.00	525.00
• ISDN PRS Voice & Data or UAS option from RCO	700.00	600.00
• DSS with Advanced Two-Way DID trunks on DS1	450.00	425.00
• DSS with Advanced Two-Way DID trunks on DS3 or higher	425.00	400.00
• DSS with Basic Two-Way trunks on DS1	650.00	600.00

The following terms and conditions apply to customers seeking to:

- New installation of PRS, RCO and/or DSS Service in all PRS or DSS disclosed wire centers and disclosed RCOs.
- Subscribers situated in non-PRS disclosed wire centers may order PRS through a serving FCO and receive promotional rates. Intraoffice Private Line mileage applies at standard tariffed rates.
- Renew expired contracts to 3- or 5-year contract terms.
- Renegotiate current PRS, RCO and/or DSS contracts if they are within six (6) months of expiration or meet existing TLA guidelines.
- Convert month-to-month pricing to 3- or 5-year contract terms.
- Migrate PBX Trunks, DSS or UAS services to PRS, RCO and/or DSS agreements (no Migration credits).
- Promotional pricing cannot be combined with any other pricing discount.
- Welcome customers back to Qwest PRS, RCO and/or DSS 3- or 5-year contracts (no Winback credits).
- No promotional pricing is available on 1- or 2-year terms.
- Promotional pricing will apply to service added up to 12 months prior to the expiration of the contract.
- Initial services must be installed and customer must accept service no later than September 30, 2009, unless a delay is caused by Qwest due to facility shortages.
- Installation charges will be waived.
- Contracts must be signed and returned to Qwest no later than the close of business August 21, 2009.

This promotion is only available where it is technically feasible to provide services and where facilities are available. This bulk price includes the DS1 facility, common equipment, Service Configuration, and a maximum of 24 trunks for DSS and 23 trunks for PRS. No other Qwest offers or promotions can be used to further discount this service.

If you have any questions or would like to discuss this notice please contact your Qwest Service Manager, Rita Urevig on (218) 723-5801. Qwest appreciates your business and we look forward to our continued relationship.

Sincerely,

Qwest Corporation

If you would like to subscribe, unsubscribe or change your current profile to Qwest Wholesale mailouts please go to the 'Subscribe/Unsubscribe' web site and follow the subscription instructions. The site is located at:

http://www.qwest.com/wholesale/notices/cnla/maillist.html

cc:
Rita Urevig

Qwest Communications 1600 7th Ave Room 1806 Seattle WA 98008